

No. 92-854-CFX Title: Central Bank of Denver, N.A., Petitioner  
Status: GRANTED V.  
First Interstate Bank of Denver, N.A. and Jack K.  
Naber  
Docketed:  
November 16, 1992 Court: United States Court of Appeals for  
the Tenth Circuit  
Counsel for petitioner: Trautman, Tucker K.  
Counsel for respondent: Gersh, Miles M., Kahn, Edwin S.  
NOTE: See mail label re dkt dt NOTE: 111992  
counsel states capt. corr as above

Entry	Date	Note	Proceedings and Orders
1	Nov 16 1992	G	Petition for writ of certiorari filed.
2	Dec 16 1992		Brief of respondents First Interstate Bank of Denver, et al. in opposition filed.
3	Dec 29 1992		DISTRIBUTED. January 15, 1993
4	Dec 31 1992	X	Reply brief of petitioner filed.
5	Jan 19 1993	P	The Solicitor General is invited to file a brief in this case expressing the views of the United States.
6	May 12 1993		REDISTRIBUTED. May 28, 1993
7	May 12 1993	X	Brief amicus curiae of United States filed.
9	Jun 1 1993		REDISTRIBUTED. June 4, 1993
10	Jun 7 1993		Petition GRANTED. limited to Question 2 presented by the petition. In addition to Question 2, the parties are directed first to brief and argue the following question: "Whether there is an implied private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5." *****
12	Jul 8 1993		Order extending time to file brief of petitioner on the merits until July 30, 1993.
17	Jul 29 1993		Record filed.
		*	Record proceedings U. S. Court of Appeals, Tenth Circuit and U. S. D. C. for the District of Colorado (BOX).
13	Jul 30 1993		Joint appendix filed.
14	Jul 30 1993		Brief of petitioner Central Bank of Denver, N.A. filed.
15	Jul 30 1993		Brief amicus curiae of American Institute of Certified Public Accountants filed.
16	Jul 30 1993		Brief amicus curiae of Securities Industry Association filed.
20	Aug 3 1993		LODGING consisting of nine copies of enlargement of page 110 of the joint appendix
19	Aug 6 1993		Order extending time to file brief of respondent on the merits until September 10, 1993.
21	Aug 19 1993	G	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
25	Sep 8 1993		Brief amici curiae of Trial Lawyers for Public Justice, et al. filed.

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Entry	Date	Note	Proceedings and Orders
23	Sep 9 1993		Brief amicus curiae of Association of the Bar of the City of New York filed.
24	Sep 9 1993		Brief amicus curiae of National Assn. of Securities and Commercial Law Attorneys filed.
22	Sep 10 1993		Brief of respondents First Interstate Bank, et al. filed.
26	Sep 10 1993		Brief amicus curiae of Securities and Exchange Commission filed.
27	Sep 24 1993		Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED. CIRCULATED.
28	Oct 6 1993		
30	Oct 13 1993	X	Reply brief of petitioner filed.
29	Oct 14 1993		SET FOR ARGUMENT TUESDAY, NOVEMBER 30, 1993. (1ST CASE).
31	Nov 30 1993		ARGUED.

92-854

Supreme Court, U.S.

FILED

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No. \_\_\_\_\_

IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1992

CENTRAL BANK OF DENVER, N.A.,

v.

*Petitioner,*

FIRST INTERSTATE BANK OF DENVER, N.A. and  
JACK K. NABER,

*Respondents.*

PETITION FOR WRIT OF CERTIORARI  
TO THE UNITED STATES COURT OF APPEALS  
FOR THE TENTH CIRCUIT

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**QUESTIONS PRESENTED**

1. Can an indenture trustee in a bond financing be liable as an aider and abettor of a Rule 10b-5 violation where it does not breach any of its indenture duties?
2. Does recklessness satisfy the scienter requirement for aiding and abetting even where there is no breach of a duty to disclose or to act?

## RULE 29.1 LIST

### A. PARENT COMPANIES

Central Bank of Denver, N.A. is wholly owned by Central Bancorporation, Inc., which is wholly owned by First Bank Systems, Inc.

### B. SUBSIDIARIES (EXCEPT WHOLLY OWNED SUBSIDIARIES)

Central Bank of Denver, N.A. owns 50% of the shares of Rocky Mountain Bankcard, Inc.

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CENTRAL BANK OF DENVER, N.A.,

*v.*

*Petitioner,*

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JACK K. NABER,

*Respondents.*

PETITION FOR WRIT OF CERTIORARI  
TO THE UNITED STATES COURT OF APPEALS  
FOR THE TENTH CIRCUIT

Central Bank of Denver, N.A. ("Central Bank") respectfully requests that a writ of certiorari be issued to review a decision of the United States Court of Appeals for the Tenth Circuit entered on July 8, 1992. The Tenth Circuit reversed the Order of the United States District Court for the District of Colorado granting summary judgment in favor of Central Bank.

**OPINIONS BELOW**

The opinion of the United States Court of Appeals for the Tenth Circuit is reported at 969 F.2d 891, and is reproduced in the Appendix at A-3. The Order of the United States District Court for the District of Colorado is reproduced in the Appendix at A-29.



## JURISDICTION

The judgment of the Court of Appeals was entered on July 8, 1992. (Appendix A-3.) Central Bank's Petition for Rehearing was denied on August 18, 1992. (Appendix A-1.) This Court's jurisdiction is invoked under 28 U.S.C. §1254(1) (1988).

## STATUTE AND RULE INVOLVED

Section 315 of the Trust Indenture Act of 1939, 15 U.S.C. §77000 (1988), and S.E.C. Rule 10b-5, 17 C.F.R. §240.10b-5 (1989), are reproduced in the Appendix at A-37.

## STATEMENT OF THE CASE

In 1986, and again in 1988, the Colorado Springs-Stetson Hills Public Building Authority (the "Authority") issued tax-exempt municipal bonds to finance the acquisition of public improvements built by the developer of Stetson Hills, a planned residential and commercial community in Colorado Springs, Colorado. Repayment of the bonds was to be made from assessments charged on sales of lots from the developer to homebuilders. Repayment was secured by land which was required to have an appraised value of 160% of the outstanding principal and interest based on a forced liquidation appraisal performed by an MAI appraiser ("160% Test").

Central Bank served as the indenture trustee for both bond issues. Central Bank's duties as trustee are specifically set forth in respective Indentures of Trust for the two bond issues. The operative provisions of the two Indentures are identical.

After both the 1986 and 1988 bonds went into default in 1989, the plaintiffs, who had purchased 1988 bonds, brought an action against participants in the issuance, including Central Bank, alleging that the sale of the bonds was in violation

of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78(j)(b) (1988), and Securities & Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5 (1989), promulgated thereunder. Plaintiffs claim that Central Bank aided and abetted the Rule 10b-5 violation of other defendants.

In early 1988, Central Bank received an updated appraisal of the land securing the 1986 bonds performed by Joseph Hastings ("Hastings"). The underwriter for the 1986 bonds raised concerns that the 160% Test for the 1986 bonds was not being met and that Hastings' appraisal was outdated. As a result of ambiguities in the bond documents and concerns over whether the 160% Test had been calculated correctly, the developer agreed to contribute additional land to secure the 1986 bonds. Central Bank asked its in-house appraiser to review the updated appraisal. His review raised questions as to the age of the comparables and whether the appraisal appropriately incorporated a bulk sale methodology in a forced liquidation context. Central Bank initially suggested that an independent review of the appraisal be done to follow up on these questions.

At a subsequent meeting, Central Bank was informed that Hastings had, in fact, reviewed more recent comparables which did not materially affect values in the appraisal and correctly followed the bulk sale methodology. Thereafter, Central Bank approved a resolution of the issue which required that Hastings supplement his current appraisal to respond to Central Bank's concerns on comparables and bulk sale methodology, that annual appraisals of land securing the 1986 and 1988 bonds be performed beginning December 1, 1988, that additional property with an approximate value of \$2,000,000 be added to the assessment lien to bring the 160% Test into compliance for the 1986 bonds and that certificates be provided by Hastings certifying that compliance. The additional land was pledged for the 1986 bonds and the required certificates of compliance were executed. Thereafter on June 15, 1988, the 1988 bonds were issued.

Plaintiffs claim that the 1988 bonds were issued and marketed through a fraudulently misleading disclosure document which did not disclose the questions raised concerning the Hastings appraisal and the 160% Test in connection with the 1986 bonds, and by means of a scheme allegedly intended to assure that an independent review of the appraisal be delayed until six months after the 1988 bonds were issued. Aiding and abetting liability against Central Bank is predicated upon its decision as trustee not to insist upon an independent review of the Hastings appraisal or a new appraisal prior to issuance of the 1988 bonds.

Central Bank moved for, and was granted, summary judgment. (Appendix A-35.) The district court held that the scienter requirement for aider and abettor liability "may not be satisfied by showing recklessness absent an additional duty to disclose." (Appendix A-33.) On July 8, 1992, the Tenth Circuit reversed, holding that recklessness was sufficient to satisfy the scienter requirement in a case based on assistance by action, (Appendix A-25), even where all of Central Bank's conduct comported with its Indenture duties and there was no breach of a duty to disclose or to act. On August 18, 1992, the Court of Appeals denied Central Bank's Petition for Rehearing. (Appendix A-2.)

### **ARGUMENT FOR GRANTING THE WRIT**

The Tenth Circuit concluded that there was a genuine issue of material fact as to whether Central Bank's conduct was reckless even though Central Bank's duties are strictly defined and limited to the terms of the Indenture and none of those duties were breached, and even though the "assistance by action" forming the basis of aider and abettor liability was the proper exercise of a discretionary right under the Indenture. This conclusion not only eviscerates the protections for indenture trustees established by Congress in the Trust Indenture Act of 1939, 15 U.S.C. §§77aaa to 77bbbb (1988), it also confounds the legal standards applicable to indenture

trustees, who play a vital role in the corporate and municipal financing mechanism. The inevitable consequences of the decision are either a reduction in the availability of such financings due to the unwillingness of financial institutions to risk participation or a substantial increase in the cost of such financings which will further burden economic development.

Moreover, the Tenth Circuit's conclusion that recklessness satisfies the scienter requirement in an aiding and abetting case, notwithstanding the absence of a breach of duty, further confuses an increasingly unsettled area of securities law — the degree of scienter required for aiding and abetting liability. While the federal circuits were once in agreement as to the circumstances under which recklessness would support aiding and abetting liability, in recent years that uniformity has severely fractured. Now there are at least three distinct tests, one of which is pushed even further from the old uniform standard by the Tenth Circuit's decision effectively reducing the scienter requirement to recklessness. Consequently, banks, as well as lawyers, accountants and other professionals who typically participate in such financing, are left with no clear guidelines as to their standard of conduct.

A writ should issue to enable the Court to more clearly define the legal standards applicable to those who participate in this critical area of commerce.

### **I. THE TENTH CIRCUIT'S DECISION DESTROYS THE PROTECTION OF INDENTURE TRUSTEES THAT CONGRESS INTENDED BY THE TRUST INDENTURE ACT.**

While the Tenth Circuit recognizes that the duties of Central Bank, as indenture trustee, "are strictly defined and limited to the terms of the indenture" (Appendix A-20), and that "Central Bank did not breach a duty under the indenture" (Appendix A-28), it nonetheless concludes that plaintiffs have presented a genuine issue of fact as to whether



"agreeing to delay the independent review [of the Hastings appraisal] was an extreme departure from the standards of ordinary care." (Appendix A-26.)

The court is correct that Central Bank's obligations, and thus its duties of care, are defined by the Indenture. While the Indenture grants Central Bank broad discretion in performing its trustee duties, it has no duties outside those specified in the Indenture, and it is undisputed that Central Bank did not breach any of its Indenture duties. It is simply a logical impossibility for Central Bank's conduct to be simultaneously in compliance with the terms of the Indenture and yet "an extreme departure from the standards of ordinary care."

Courts in other circuits recognize the limited role, and thus the limited obligations, of indenture trustees. In *Elliott Assoc. v. J. Henry Schroder Bank & Trust Co.*, 838 F.2d 66, 71 (2d. Cir. 1988), the Second Circuit concluded that "so long as the trustee fulfills its obligations under the express terms of the indenture, it owes the debenture holders no additional, implicit pre-default duties or obligations . . . ."<sup>1</sup> Similarly, in *Lorenz v. CSX Corp.*, 736 F. Supp. 650, 658 (W.D. Pa. 1990) (citations omitted), the Court recognized that:

[W]here the duties of an issuer (and a Trustee) to debenture holders are circumscribed by the Indenture Agreement, no extraordinary duties will be implied under the federal securities laws.

<sup>1</sup> In *Elliott Assoc.*, the plaintiff alleged that the trustee breached its fiduciary duty by waiving a 50-day notice requirement in connection with a debenture redemption, resulting in the loss of a \$1.2 million interest payment to debenture holders. The Second Circuit affirmed the district court's dismissal of the action, holding that the indenture granted the trustee the discretion to waive the notice requirement, and that the trustee had no duties outside those stated in the indenture; therefore it had no fiduciary duty. Likewise, in this case the Indenture gave Central Bank the discretion to determine when and if an independent review of the appraisal should be done, and Central Bank had no duties outside those stated in the Indenture.

We have not uncovered any contrary authority, imposing on an Indenture Trustee greater duties under § 10(b) than are required by the Indenture . . . . There is likewise no authority for the premise that an Indenture Trustee who complies with the requirements of the Indenture can still be liable for his silence as an aider and abettor to another's violation.

The Tenth Circuit's unprecedented conclusion that a trustee could be reckless even when it does not breach its duties is not only contradicted by these other decisions; it also directly conflicts with the provisions, policy and legislative history of the Trust Indenture Act of 1939. Indenture trustees, as intermediaries between issuer and bondholders, are an essential component of corporate and municipal financing.<sup>2</sup> Banks play an integral role in the trust indenture process that brings this type of financing to the public market. *Meckel v. Continental Resources Co.*, 758 F.2d 811, 815 (2d Cir. 1985). Congress expressly and deliberately limited the liability of an indenture trustee to further these important

<sup>2</sup> The legislative history of the Trust Indenture Act states the following:

Although the trust indenture was originally devised to meet technical legal requirements in connection with the enforcement of mortgages securing obligations held by several holders, its use has become a practical necessity where bonds are to be nationally distributed among investors in a number of States, whose individual holdings are likely to be small. Even if the average bondholder had the necessary initiative and knowledge, it would acquire a disproportionate expenditure of time and money for him to attempt to make an individual check upon the performance of the obligations assumed by the obligor, or to enforce his rights by individual action. Duplication of effort and expense is avoided through the issuance of the bonds under a trust indenture which vests in the indenture trustee powers with respect to enforcement of the issuer's obligations and the bondholder's rights.

S. Rep No. 248, 76th Cong., 1st Sess. 3 (1939).

policy considerations. The original draft of the Act imposed an overriding obligation on the Trustee to adhere to a prudent person's standard. However, after extensive committee hearings, the final bill which was adopted did not impose any obligations other than those contained in the express terms of the trust indenture. *Elliott Assoc. v. J. Henry Schroder Bank & Trust Co.*, 838 F.2d at 71. With respect to a trustee's pre-default duties, like those at issue here, Section 315 of the Trust Indenture Act as originally enacted permits the indenture to provide that "the indenture trustee shall not be liable except for the performance of such duties as are specifically set out in such Indenture . . . ." 15 U.S.C. § 77000 (1988).<sup>3</sup> Thus, Congress encouraged participation by indenture trustees and protected their discretion and their vital role in the corporate and municipal financing mechanism.

The Indenture in this case complies with the principles and requirements of the Trust Indenture Act. Central Bank, as trustee, was to "perform such duties and only such duties as are specifically set forth in this Indenture." (Indenture, § 9.01(a).)<sup>4</sup> The Indenture provides that "the Trustee shall not be responsible for . . . the sufficiency of the security for the Bonds issued hereunder or intended to be secured hereby." (Indenture, § 9.01(c).) However, the Indenture grants the trustee very broad discretion by providing that:

Notwithstanding anything elsewhere in this Indenture with respect to . . . any action whatsoever within the purview of this Indenture, the Trustee shall have the right, but shall not be required, to demand any showings, certificates, opinions,

<sup>3</sup> In 1990 this section was amended to state that the indenture will automatically be deemed to include such a provision unless expressly excluded. 15 U.S.C. § 77000 (Supp. II 1990).

<sup>4</sup> Article IX of the Indenture of Trust dated May 15, 1988 is reproduced in the Appendix at A-41.

appraisals or other information . . . deemed desirable for the purpose of . . . any other action by the Trustee.

(Indenture, § 9.01(k).) And yet, it is Central Bank's ultimate decision not to exercise that discretionary right to require an independent review of the Hastings appraisal prior to the issuance of the bonds that forms the basis for the claim of extreme departure from the trustee's standard of care. Here, again, the Indenture clearly protects a trustee's discretion to delay exercising a right or to forego it altogether: "The permissive right of the Trustee to do things enumerated in this Indenture shall not be construed as a duty . . ." (Indenture, § 9.01(g).)

The Tenth Circuit's decision has the precise chilling effect on trustees that Congress intended to eliminate. Often, as in this case, exercise of a trustee's discretion involves choosing alternative courses of action including affirmative acts or even inaction. Because an indenture trustee, unlike an ordinary trustee, stands in a unique position between the issuer and the bondholders,<sup>5</sup> it is inherently difficult to judge whether an indenture trustee has chosen the proper course. Clearly, by making trustees accountable only for failure to perform their express duties, Congress intended to protect a trustee's exercise of discretion from challenge in order to encourage their involvement in such financing and the exercise of their discretion to solve problems that may arise in such financing. In hindsight, a trustee's exercise of discretion may turn out to be the wrong decision. If trustees can be second guessed, as Central Bank has been here by the plaintiffs, they will be hesitant to take any action to resolve

<sup>5</sup> In *Elliot Assoc. v. J. Henry Schroder Bank & Trust Co.*, 838 F.2d at 71, the Second Circuit recognized the divided loyalty of indenture trustees: "[W]e have consistently rejected the imposition of additional duties on the trustee in light of the special relationship that the trustee already has with *both the issuer and the debenture holders* under the indenture." (Emphasis added.)



problems which arise, or worse, they will be deterred from acting as trustees for fear of violating an unspecified duty imposed after the fact by judge or jury in the context of aiding and abetting liability for alleged recklessness.

The Tenth Circuit's decision ignores the express terms of the Indenture and the mandate of Congress that trustees be protected from the kind of second guessing in which the plaintiffs and the Tenth Circuit engage.

## II. THE TENTH CIRCUIT'S DECISION, EFFECTIVELY ESTABLISHING RECKLESSNESS AS THE UNIFORM STANDARD FOR SCIENTER, CONFLICTS WITH THE MAJORITY OF THE FEDERAL CIRCUITS.

In reaching its conclusion that Central Bank's conduct raised genuine issues of material fact as to whether it acted recklessly, the Tenth Circuit first determined that recklessness satisfies the scienter element of an aiding and abetting case based on assistance by action, even in the absence of a duty to disclose. (Appendix A-25.) This conclusion conflicts with decisions of a majority of the federal circuits.

This Court has held that to be liable under the federal securities laws, one must have acted with the requisite scienter, that is, an "intent to deceive, manipulate or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976), *reh'g denied*, 425 U.S. 985 (1986). However, the Court left open the question of whether recklessness satisfies the scienter requirement. Mindful of the Court's requirement of intent, the majority of federal circuits require proof of three elements for aiding and abetting: 1) a securities violation by a primary violator; 2) knowledge of the wrong by the alleged aider and abettor and of his role in it; and 3) substantial assistance. See, e.g., *Schatz v. Rosenberg*, 943 F.2d 485, 495 (4th Cir. 1991); *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983); *Stokes v. Lokken*, 644 F.2d 779, 782-783 (8th

Cir. 1981); *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 94-97 (5th Cir. 1975).

The majority of federal courts have concluded that recklessness satisfies the scienter requirement for aiding and abetting liability only in limited circumstances — where there is a duty to disclose. Where there is no disclosure duty, the scienter requirement for aiders and abettors remains conscious intent to defraud.

[D]espite allegations of Bear Stearns' reckless disregard of the facts — and even assuming for present purposes that the requisite standard of recklessness has been adequately pleaded — absent a fiduciary duty owing from Bear Stearns to Ross there is no aiding and abetting liability . . . [I]f there is no fiduciary duty — and appellants concede there is none here — the scienter requirement increases, so that appellants need to show that Bear Stearns acted with actual intent.

*Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990); see also *IIT v. Cornfeld*, 619 F.2d 909, 925 (2d Cir. 1980) (when it is impossible to find a duty of disclosure, an alleged aider and abettor should be found liable only if scienter of the high "conscious intent" variety can be proved); *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983) ("Courts generally have held that in the absence of a duty of disclosure, a defendant should be held liable as an aider and abettor only if the plaintiff proves that the defendant had actual knowledge of the improper activity of the primary violator and of his role in that activity."); *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1128 (5th Cir. 1988) ("Aroused suspicions, however, do not constitute actual awareness of one's role in a fraudulent scheme. Moreover, to prove plainly that an alleged abettor intended to violate the securities laws, plaintiffs must prove more than that the abettor recklessly ignored danger signals."), *cert. denied*, 492 U.S. 918 (1989), and *vacated on other grounds sub nom. Fryar v. Abell*, 492 U.S. 914 (1989);

*Woods v. Barnett Bank of Fort Lauderdale*, 765 F.2d 1004, 1009-11 (11th Cir. 1988) (recklessness satisfied the scienter requirement because the defendant assumed a special duty to disclose).<sup>6</sup>

In deciding this case, the Tenth Circuit rejected the majority view and adopted the minority position maintained by the Ninth Circuit.<sup>7</sup> The Ninth Circuit has eliminated the requirement of a duty to disclose which effectively establishes recklessness as the universal standard for scienter. While the Ninth Circuit requires the same three elements of aiding and abetting as the majority of federal circuits, it concludes that "[t]he secondary violator's duty to disclose may arise from a 'knowing assistance of or participation in a fraudulent scheme.'" *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d 646, 653 (9th Cir. 1988). Thus, under the Ninth Circuit's test, when an alleged aider and abettor substantially assists a primary violation (that is, whenever the third

<sup>6</sup> The Seventh Circuit requires even more. In addition to knowledge and substantial assistance, an aider and abettor must have also committed one of the "manipulative or deceptive" acts prohibited under Rule 10b-5(2) with the same degree of scienter that primary liability requires. *Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1123 (7th Cir. 1990), cert. denied, 111 S. Ct. 1317 (1991). Thus, where the first element of aider and abettor liability in the other circuits merely requires a primary violation by the one the aider and abettor assists, the Seventh Circuit requires essentially a primary violation by the aider and abettor himself; that is, the aider and abettor must have made either an untrue statement of material fact or an omission of a material fact in breach of a duty to disclose with the intent to mislead and which causes plaintiff's loss. *Id.* at 1123 n.4, 1125.

<sup>7</sup> The Court's opinion also relies on *FDIC v. First Interstate Bank, N.A.*, 885 F.2d 423 (8th Cir. 1989). (Appendix A-25.) Yet that decision, and a subsequent Eighth Circuit case, *Camp v. Dema*, 948 F.2d 455 (8th Cir. 1991), require more than recklessness in the absence of a duty to disclose. "Because Kidder did not owe Camp a duty to disclose, the knowledge requirement may not be satisfied by recklessness." *Camp*, 948 F.2d at 462 (citing *FDIC*, 885 F.2d at 432-433).

element is met), a duty to disclose automatically arises.<sup>8</sup> In *Levine v. Diamantheset, Inc.*, 950 F.2d 1478 (9th Cir. 1991), the Ninth Circuit drops the pretense of the duty to disclose requirement altogether, and simply concludes that recklessness suffices where there is assistance by action.

Following *Levine*, the Tenth Circuit states that

The Ninth Circuit's recent opinion in *Levine* is particularly enlightening . . . the *Levine* court considered the case before it as one based on assistance by action and for that reason expressly found irrelevant a question whether the alleged aiders-and-abettors had a duty to disclose. Further, in holding that the plaintiff's allegations adequately stated claims for aiding-and-abetting liability, the court applied a recklessness standard.

(Appendix A-24.) (Citations omitted.) Thus, the Tenth Circuit concludes that recklessness satisfies the scienter requirement even though it expressly finds no duty to disclose and even though the "assistance by action" was nothing more than the discretionary decision not to act permitted by the Indenture.

The flaw in the analysis of the Tenth, as well as the Ninth, Circuits is monumental. Successful financing necessarily involves participation by several independent professionals including accountants, appraisers, lawyers, indenture trustees, investment bankers and others who each "assist" in the financing by applying their particular expertise to a specific component of the transaction. This division of labor allows each participant to rely upon the efforts and expertise of others in a predictable and cost-efficient manner. Since each necessarily takes action in connection with the financing, the

<sup>8</sup> See Joel S. Feldman, *The Breakdown of Securities Fraud Aiding and Abetting Liability: Can a Uniform Standard Be Resurrected?* 19 Sec. Reg. L.J. 45, 64-66 (1991).



Tenth Circuit's test of "assistance by action," applied without reference to the existence of a duty to disclose, will invariably be met with regard to each such participant, effectively reducing the test for scienter in aiding and abetting cases against such professionals to mere recklessness.

Under the majority rule, professionals who assist in such financing are subject to aiding and abetting liability under the lower recklessness standard only when they are also under a state law duty to disclose, thus providing guidance to those would-be defendants to investigate or otherwise take preventative action to avoid such liability. Now the expanding minority view, taken to an extreme by the Tenth Circuit opinion, replaces those guidelines with chaos as participants who have no disclosure duties, such as Central Bank in this case, can be liable as aiders and abettors for merely doing their jobs. In discussing primary liability under Rule 10b-5, this Court has previously established the necessity for a duty to disclose before finding silence a manipulative or deceptive device. *Chiarella v. United States*, 445 U.S. 219 (1980). For the same reasons, financing participants should be liable for aiding and abetting under a recklessness standard only when they violate some independent duty to disclose (or act).

It is imperative that this Court resolve these divergent views and reaffirm "intent" as an essential element of aider and abettor liability. Without such a requirement, financing participants will be unable to know where their responsibilities end (and others' begin), causing increased duplication of effort (and resulting cost) in such financings. The federal courts, at least in certain circuits, will increasingly become super-malpractice courts applying a recklessness standard to such professionals carrying out their responsibilities in connection with corporate and municipal financing.

In the meantime, confusion dominates among bankers, lawyers, accountants and all others who provide essential

services in corporate or municipal financing. Without uniformity of aiding and abetting elements, there is no standard by which these professionals can be guided in their conduct. Practices acceptable in one region invite liability in another. Ultimately, the uncertainty will take its toll on the transactions themselves, rendering financing either too risky or too costly to make economic sense.

## CONCLUSION

This Court's guidance on these fundamental issues is gravely needed. The lower courts are chipping away at the protections afforded indenture trustees by Congress, and are moving further from agreement on standards of conduct in an essential area of national commerce. For these reasons, a writ of certiorari should issue.

Respectfully submitted this 12th day of November, 1992.

TUCKER K. TRAUTMAN

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*Attorneys for Petitioner*

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UNITED STATES COURT OF APPEALS  
FOR THE TENTH CIRCUIT

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No. 90-1315

FIRST INTERSTATE BANK OF DENVER; JACK K. NABER, on  
behalf of himself and all others similarly situated,

*Plaintiffs-Appellants,*

AND

IDS HIGH YIELD TAX-EXEMPT FUND INC.,

*Plaintiff,*

v.

DBLKM INC., FKA KIRCHNER MOORE & COMPANY; HANIFEN  
IMHOFF, INC.; COLORADO SPRINGS-STETSON HILLS PUBLIC  
BLDG AUTHORITY; KUTAK, ROCK & CAMPBELL,

*Defendants,*

AND

ROY PRING; CENTRAL BANK & TRUST COMPANY OF DENVER,

*Defendants-Appellees,*

v.

DBLKM INC., FKA KIRCHNER MOORE & COMPANY,

*Third-Party-Plaintiff,*

v.

RESOLUTION TRUST CORPORATION, as Conservator of Capitol  
Federal Savings and Loan Association of Denver — Capitol  
Federal and Savings and Loan Association of Denver;  
DELOITTE, HASKINS & SELLS; AMWEST DEVELOPMENT COR-  
PORATION; AMWEST DEVELOPMENT I LIMITED PARTNER-  
SHIP; DAVID J. POWERS; MARK O. LORDS; GEORGE JURY,  
SR.; RICHARD G. ZINN,

*Third-Party-Defendants.*



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ORDER

Entered August 18, 1992

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Before MCKAY, Chief Judge, LOGAN, SEYMOUR, MOORE, ANDERSON, TACHA, BALDOCK, BRORBY, EBEL, and KELLY, Circuit Judges, and BRIMMER\*, District Judge.

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\*The Honorable Clarence A. Brimmer, District Judge, United States District Court for the District of Wyoming, sitting by designation.

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This matter comes on for consideration of appellee Roy Pring's petition for rehearing and appellee Central Bank of Denver's petition for rehearing and suggestion for rehearing en banc.

Upon consideration whereof, the petitions for rehearing are denied by the panel that rendered the decision.

In accordance with Rule 35(b), Federal Rules of Appellate Procedure, the suggestion for rehearing en banc was transmitted to the panel judges and to all of the judges of the court who are in regular active service. No member of the panel and no judge in regular active service on the court having requested that the court be polled on rehearing en banc, Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing en banc is denied.

Entered for the Court

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/s/ Robert L. Hoecker  
ROBERT L. HOECKER, Clerk

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PUBLISH

UNITED STATES COURT OF APPEALS  
TENTH CIRCUIT

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No. 90-1315

FIRST INTERSTATE BANK OF DENVER, N.A. AND JACK K. NABER,

*Plaintiffs-Appellants,*

v.

ROY I. PRING AND CENTRAL BANK AND TRUST COMPANY OF DENVER,

*Defendants-Appellees.*

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Appeal from the United States District Court  
for the District of Colorado  
(D.C. Nos. 89-F-1250 and 89-F-1806)

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Miles M. Gersh (Laurie K. Rottersman, also of Gersh & Danielson; and Edwin S. Kahn of Kelly/Haglund/Garnsey & Kahn, with him on the briefs), Denver, Colorado, for Plaintiffs-Appellants.

Miles C. Cortez, Jr. (Stephen J. Hensen with him on the briefs), Cortez & Friedman, Denver, Colorado, for Defendant-Appellee Roy I. Pring.

Tucker K. Trautman (Neal S. Cohen and Polly A. Atkinson with him on the briefs), Ireland, Stapleton, Pryor & Pascoe, Denver, Colorado, for Defendant-Appellee Central Bank of Denver.

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Before LOGAN and TACHA, Circuit Judges, and BRIMMER, District Judge.\*

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LOGAN, Circuit Judge.

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\* The Honorable Clarence A. Brimmer, Chief Judge, United States District Court for the District of Wyoming, sitting by designation.

Plaintiffs First Interstate Bank of Denver, N.A. and Jack K. Naber appeal from the district court's grant of summary judgment for defendants Roy I. Pring (Pring) and Central Bank of Denver (Central Bank). Plaintiffs assert claims under § 10(b) and § 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) and 78t(a), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5.

# I

The securities involved in this case are \$11 million in bonds issued in June 1988 by the Colorado Springs-Stetson Hills Public Building Authority (the Authority).<sup>1</sup> Previously, in 1986, the Authority had issued \$15 million in bonds. The 1986 and 1988 bonds were similar. Both were issued to reimburse the developer for the cost of public improvements in a planned residential and commercial development in Colorado Springs called Stetson Hills. Bondholders were to be repaid from assessments paid to the developer by commercial builders, or from a reserve fund. The bonds were secured by "landowner assessment liens" covering approximately 250 acres for the 1986 bond issue and approximately 272 acres for the 1988 bond issue. Under the bond covenants the land subject to the liens was required to be worth at least 160% of the bonds' outstanding principal and interest (the 160% test). Plaintiffs purchased some of the 1988 bonds, which later went into default.

The developer of Stetson Hills was AmWest Development I Limited Partnership (AmWest L.P.). The sole general partner of AmWest L.P. was AmWest Development Corporation (AmWest). Three AmWest officers were the only members of the board of directors of the Authority, including David J. Powers, AmWest's majority shareholder and chairman of

<sup>1</sup> The Authority defaulted early in the litigation. Plaintiffs settled claims against the underwriters of the 1988 bonds.

AmWest's board of directors, and Gregory D. Timm, AmWest's president and a member of its board.

Defendant Pring was involved in the Stetson Hills development as one of the original owners of the property, as an investor in AmWest L.P., and as a creditor, officer, and director of AmWest. Pring and his family in 1983 entered into an option agreement with AmWest to sell the 2135 acres that became the Stetson Hills property.<sup>2</sup> The optionee was changed from AmWest to AmWest L.P. in 1986. AmWest L.P. then partially exercised the option, purchased portions of the property, and began development. Pring and his family continued to own, subject to the option agreement, the remainder of the land within Stetson Hills.

Pring and his family formed Pring Investments, Ltd., a limited partnership, with Pring as the sole general partner; Pring Investments, Ltd. later became a twenty percent shareholder of AmWest. Pring and his wife made a loan of \$1.37 million to AmWest; this loan later was converted into a limited partnership contribution in AmWest L.P. whereby Pring and his wife each came to hold 17.5% interests in AmWest L.P. Pring and his wife also made a loan of \$5 million to AmWest L.P. Beginning in 1983 Pring was a vice-president<sup>3</sup> and director of AmWest. In February 1988, before the 1988 bonds were issued, his term as vice-president expired; in December 1988, after the 1988 bonds were issued, he resigned as director.

Central Bank served as the indenture trustee for both bond issues. In January 1988 Central Bank received an "updated" appraisal of the land securing the 1986 bonds that also included the land proposed to secure the 1988

<sup>2</sup> Pring and his wife owned 51% of the Stetson Hills property; other members of Pring's family owned the remaining 49%. In entering the option agreement Pring acted as attorney in fact for the other members of his family.

<sup>3</sup> Pring and others state that he was only an "honorary" vice-president.



bonds.<sup>4</sup> This appraisal was performed by Joseph Hastings, the appraiser who in 1986 had performed the original appraisal of the land securing the 1986 bonds. The updated appraisal showed land values essentially unchanged from the earlier 1986 appraisal.

Thereafter Central Bank became aware of serious concerns about the adequacy of the security for the 1986 bonds and the accuracy of the Hastings appraisal. Central Bank received from the senior underwriter of the 1986 bonds a letter that expressed concern that the 160% test was not being met. The letter also expressed concern about declining property values in Colorado Springs and the fact that they were operating on an appraisal that was over sixteen months old. The letter suggested that the Authority may have given "false or misleading certifications" of compliance with the bond covenants. I R. tab 12, ex. G at 455.<sup>5</sup> Subsequently, after

<sup>4</sup> Central Bank rejected the "updated" appraisal because it combined the property securing the 1986 bonds and that proposed to secure the 1988 bond issue. The appraiser, Joseph Hastings, later separated the appraisals.

<sup>5</sup> The letter closed with the following two paragraphs:

At this date we are operating on an appraisal that is over 16 months old. In light of the declining property values in Colorado Springs and the foreclosure sales, many of which have occurred within the vicinity of the collateral, an appraisal that reflects property values similar to those utilized for the 1986 appraisal of record should be suspect and not relied on without further independent check. As Trustee, you have the authority to name an independent appraisal if you are not satisfied.

It appears that the officers of the Stetson Hills Building Authority have failed to conform to the Bond Covenants to which they agreed. In the interest of the bondholders I call upon you to the [sic] enforce the covenants or Invoke the Remedies. It is our opinion that, based on your statement to us and based on the project analysis, in addition to a reserve fund deficiency the Stetson Hills Public Building Authority is not meeting either the 110% or the 160% Test.

I R. tab 12, ex. G at 456.

reviewing the updated Hastings appraisal, the 1986 underwriter wrote a second letter to Central Bank expressing serious concerns that the updated appraisal was using outdated real estate values.

Central Bank investigated. Some information contradicted the 1986 underwriter's concerns.<sup>6</sup> Central Bank asked its own in-house appraiser to review the Hastings updated appraisal. He did so, expressed concerns about the age of comparable sales used and the methodology used, and suggested that there be an independent review of the appraisal. Apparently Central Bank trust officer Cheryl Crandall calculated that even under the Hastings appraisal, the collateral value did not meet the 160% test. See I R. tab 12, ex. B at 115. In light of all the foregoing, as trustee for the 1986 bonds, in a letter dated March 22, 1988, Central Bank required "that an independent review of the appraisal be conducted by a different appraiser." I R. tab 12, ex. I. Central Bank's letter to Timm stated three reasons for requiring an independent review: (1) the comparable sales data was outdated; (2) the methodology did not consider a bulk sale in a forced liquidation context; and (3) considering the local real estate market the values appeared "unjustifiably optimistic." *Id.*

<sup>6</sup> Central Bank inquired as to why the values in the updated appraisal were substantially unchanged from the original appraisal despite declines in local real estate values. A representative of AmWest and the Authority, Timm, said the reason was that \$10 million in improvements had been added to the property since the original appraisal. Timm wrote Central Bank's trust officer handling the 1986 bonds that the concerns expressed in the 1986 underwriter's letter were "unfounded." II Supp.R. tab 65. In addition, a different underwriter for the planned 1988 bond issue disputed several things in the 1986 underwriter's letters, including the method of calculating the 160% test and the suggestion that the Authority may have made false or misleading certifications. See II Supp.R. tab 72, ex. 72B.

Thereafter there was a flurry of meetings and communications between Central Bank and Timm and others.<sup>7</sup> The ultimate result was that Central Bank agreed to delay an independent review of the Hastings updated appraisal until the end of the year, approximately six months after the closing on the 1988 bond issue.

At least by March 1988 Pring knew that the appraisal had been questioned and that AmWest was experiencing or anticipating cash flow problems. Pring had communications with Timm in which AmWest expressed a need to acquire additional land under the option agreement. AmWest proposed that, instead of Pring receiving cash for the land purchase, Pring finance the purchase and requested that Pring agree to

<sup>7</sup> On March 31 a Central Bank vice-president, Ken Buckius, met with Timm and representatives of the underwriter for the proposed 1988 bonds. Timm assured Buckius and the others that the Hastings appraisal, in fact, had considered more recent comparable sales and these had not materially affected the values. Timm also said that Hastings had used the proper methodology. Apparently Timm indicated a willingness to add approximately \$2 million worth of property to the 1986 assessment lien to bring the 160% test into compliance. Timm offered to have Hastings provide a certification regarding the updated appraisal. Timm objected to Central Bank's requirement of an independent review of the Hastings updated appraisal and offered instead to have a different appraiser do a new appraisal at the end of calendar year 1988.

Central Bank's trust committee met on or about April 5 to consider Timm's proposal to delay the independent review. The committee agreed to accept the proposal. This agreement, with conditions that included adding approximately \$2 million worth of property to the assessment lien, was conveyed to Timm in a letter dated April 8 from Buckius. See II Supp. R. tab 75. Thereafter, on May 13, a little more than one month before the closing on the 1988 bonds, Timm sent a letter to Central Bank on behalf of the Authority and the developer. The letter indicated that annual appraisals of the land securing the 1986 bonds and the proposed 1988 bonds would be provided, with the first of these to be completed within ninety days of December 1, 1988. Buckius countersigned the letter, signifying Central Bank's agreement. See II Supp. R. tab 240.

"cash flow arrangements." Pring refused.<sup>8</sup> It is undisputed that Pring stayed silent and took no action to bring what he knew to the attention of plaintiffs. From the proceeds of the 1988 bond issue Pring received almost \$2 million from AmWest L.P. as payment for land purchases and as interest due on Pring's \$5 million loan to AmWest L.P.

The December 1988 appraisal was begun, but the Authority refused to complete it. The 1988 bondholders were notified of the Authority's technical default. Thereafter, the Authority defaulted on payments on the 1988 bonds.

Plaintiffs allege that the 1988 bonds were sold as part of a fraudulent scheme. Plaintiffs allege that the official statement for the 1988 bonds was materially false and misleading by, inter alia, (1) representing the Hastings updated appraisal as being reliable, prudent, and correct; and (2) failing to disclose certain facts, including that Pring had refused to extend additional credit to AmWest, that Pring would receive almost \$2 million from the bond proceeds, that serious concerns had been raised about the accuracy of the Hastings updated appraisal, that Central Bank had required an independent review of the appraisal, that the developer had refused to provide it, and that Central Bank later had agreed to delay the independent review until December 1988.

## II

We review de novo the district court's summary judgment rulings. *Eastman Kodak Co. v. Westway Motor Freight, Inc.*,

<sup>8</sup> The record includes a letter from Timm to Pring with the following handwritten notation at the bottom: "Met with [Timm]. Told him I had as much money involved in AmWest now, as I ever intend to have. I will not loan more money or forego payments due us, voluntarily." I R. tab 13, ex. G.



949 F.2d 317, 319 (10th Cir. 1991). We apply the same standard as the district court: "[s]ummary judgment is appropriate 'if . . . there is no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law.' " *Id.* (quoting Fed. R. Civ. P. 56(c)). We must view the evidence in the light most favorable to the party opposing summary judgment. *World of Sleep, Inc. v. La-Z-Boy Chair Co.*, 756 F.2d 1467, 1474 (10th Cir.), *cert. denied*, 474 U.S. 823 (1985). If a reasonable trier of fact could return a verdict for the nonmoving party, summary judgment is inappropriate. See *Windon Third Oil & Gas Drilling Partnership v. FDIC*, 805 F.2d 342, 346 (10th Cir. 1986), *cert. denied*, 480 U.S. 947 (1987).

We first address plaintiffs' § 20(a) claim that Pring is liable as a controlling person of the issuer through his relationship with AmWest L.P. and AmWest. The district court applied the following two-part test for a controlling person: "(1) [defendant] actively participated in overall management and operation of the controlled entity and (2) [defendant] actively participated, in some meaningful sense, in the fraud perpetrated by that entity." I R. tab 17 at 4 (citing *Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973) (en banc); *Harrison v. Enventure Capital Group, Inc.*, 666 F. Supp. 473, 478 (W.D.N.Y. 1987)). The district court held that Pring was not a controlling person because "plaintiffs' evidence fails to establish that Pring *actually participated in the alleged fraud* of the developer or the issuer of the [b]onds." *Id.* (emphasis added). Because it looked to plaintiffs' evidence, the district court clearly put the burden on plaintiffs to show that defendant actually participated in the alleged fraud.

We begin our analysis with the language of the statute. Section 20(a) of the Securities Exchange Act of 1934 provides:

Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also

be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78t(a). The statute first defines a controlling person as one "who, directly or indirectly, controls any person [who is] liable" for violations of the securities laws.<sup>9</sup> The final clause of the statute provides that even if a person is a controlling person, he nevertheless is not liable if he "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." The statutory language clearly suggests a two-step analysis for § 20(a) liability: (1) determining whether the defendant is a controlling person; and (2) if so, determining whether the defendant nevertheless is entitled to the good-faith defense stated in the statute's final clause.

This court has addressed the definition of controlling person under § 20(a) in only one prior case. In *Richardson v. MacArthur*, 451 F.2d 35 (10th Cir. 1971), we stated that "[t]he statute is remedial and is to be construed liberally. It has been interpreted as requiring only some indirect means of discipline or influence short of actual direction to hold a 'controlling person' liable." *Id.* at 41-42 (quoting *Myzel v. Fields*, 386 F.2d 718, 738 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968)). We went on to hold that an insurance company was a controlling person over an employee who handled virtually all of the company's business in one state. *Id.* at 42. Our conclusion in *Richardson* that one can be a

<sup>9</sup> In the regulations of the Securities and Exchange Commission (SEC) control is defined as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." 17 C.F.R. § 230.405.

controlling person despite exercising only *indirect* control follows the language of the statute.

More recently this court addressed the controlling person provision of § 15 of the Securities Act of 1933,<sup>10</sup> 15 U.S.C. § 77o, in *San Francisco-Oklahoma Petroleum Exploration Corp. v. Carstan Oil Co.*, 765 F.2d 962 (10th Cir. 1985). Although § 15 and § 20(a) are not identical, the controlling person analysis is the same. *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1578 (9th Cir. 1990) (en banc), *cert. denied*, 111 S. Ct. 1621 (1991). In *Carstan Oil*, we said that a plaintiff had established a *prima facie* case of controlling person liability "when the [primary] violation was established, and when this defendant was shown to be a controlling person." 765 F.2d at 964. We stated that to be a controlling person one "need not have been involved in the particular transaction which became the subject of the litigation." *Id.* at 965. We also said that "[t]he defendant had the burden to demonstrate the" defense provided in the last clause of § 15. *Id.* at 964.

We believe that the allocation of the burdens for controlling person liability under § 20(a) should be the same as under § 15. A natural reading of both statutes is that a plaintiff's *prima facie* case consists of both a primary violation and "control" by the alleged controlling person. The final clause of both statutes ("unless the controlling person . . ."), suggests that determining the defense should follow a finding that the defendant is a controlling person.

<sup>10</sup> Section 15 provides:

Every person who . . . controls any person liable under sections 77k or 77l of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

15 U.S.C. § 77o.

Furthermore, circuit precedent is that the defendant has the burden to establish the defense under § 15, and like the Fifth Circuit "we are not aware of any reason the burden of proof should be different, especially since the sentence structure of the two statutes is similar." *G.A. Thompson & Co. v. Partridge*, 636 F.2d 945, 958 n.23 (5th Cir. 1981).

Placing the burden of establishing the defense on the defendant makes sense because "there would be little reason for the controlling person provision unless it differed in some meaningful ways from the standards for noncontrolling person liability." *Id.* A number of other circuits place the burden of establishing the defense on the defendant. *E.g.*, *Hollinger*, 914 F.2d at 1575 & n.25 (citing cases from the Second, Fifth, Sixth, Seventh and District of Columbia Circuits); *Metge v. Baehler*, 762 F.2d 621, 631 (8th Cir. 1985) ("good faith and lack of participation are affirmative defenses in a controlling person action"), *cert. denied*, 474 U.S. 1057, and *cert. denied*, 474 U.S. 1072 (1986). Thus, once a plaintiff establishes a primary violation and that the defendant is a controlling person under § 20(a), the defendant then has the burden to show that he "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." 15 U.S.C. § 78t(a).

Nowhere in the statute does it say that to be a controlling person a defendant must have actually participated in the primary violation. "[T]he statute premises liability solely on the control relationship, subject to the good faith defense. According to the statutory language, once the plaintiff establishes that the defendant is a 'controlling person,' then the defendant bears the burden of proof to show his good faith." *Hollinger*, 914 F.2d at 1575.

Thus, the language of the statute causes us to reject those decisions that may be read to require a plaintiff to show the defendant actually or culpably participated in the primary violation. *See, e.g.*, *Sharp v. Coopers & Lybrand*, 649 F.2d



175, 185 (3d Cir. 1981) (§ 20(a) requires “‘culpable participation’ in the securities violation”), *cert. denied*, 455 U.S. 938 (1982); *Carpenter v. Harris, Upham & Co.*, 594 F.2d 388, 394 (4th Cir.) (controlling person must “in some meaningful sense [be a] culpable participant[] in the acts perpetrated by the controlled person”), *cert. denied*, 444 U.S. 868 (1979); *Lanza v. Drexel & Co.*, 479 F.2d 1277, 1299 (2d Cir. 1973) (en banc) (same). Rather, the language of the statute leads us to join those circuits that hold that a plaintiff need not prove that the defendant actually or culpably participated in the primary violation. *E.g.*, *Hollinger*, 914 F.2d at 1575 (“a plaintiff is *not* required to show ‘culpable participation’ ”); *Metge*, 762 F.2d at 631 (rejecting the more restrictive culpable participation test); *G.A. Thompson & Co.*, 636 F.2d at 958 (the statute . . . [does not] require participation in the wrongful transaction”). This conclusion is consistent with this circuit’s test for a controlling person under § 15. *See Carstan Oil*, 765 F.2d at 965.

Under this allocation of the burdens, the district court erred when it placed on plaintiffs the burden regarding defendant’s actual participation in the primary violation. Actual participation in the primary violation is not part of plaintiffs’ prima facie case under § 20(a); rather, nonparticipation in acts inducing or constituting the primary violation, and good faith, are part of defendant’s defense.

Applying the broad definition of control in the statute and the SEC regulation, we hold that the evidence viewed in the light most favorable to plaintiffs would support a finding by the trier of fact that Pring is a controlling person of the Authority for purposes of § 20(a). Pring was (1) a director of AmWest at all relevant times; (2) a vice-president of AmWest until February 1988; (3) the sole general partner of Pring Investments, Ltd., a twenty percent shareholder in AmWest; (4) with his wife, a thirty-five percent interest holder in AmWest L.P.; (5) with his wife, a \$5 million creditor of AmWest L.P.; and (6) with his wife, and as attorney-in-fact

for others in his family, the owner and controller of the remaining land under the option agreement with AmWest L.P. These facts demonstrate that Pring was in a position of at least indirect control over AmWest and AmWest L.P. Because AmWest and AmWest L.P. controlled the Authority,<sup>11</sup> Pring’s at least indirect control extended to the Authority.

Having determined that the evidence is sufficient to avoid summary judgment against plaintiffs on the issue whether Pring is a controlling person, the second step of the § 20(a) analysis is whether Pring can establish that he acted in good faith and did not participate in acts inducing the primary violation. We leave the determination of this question for the district court on remand.

### III

Next we address plaintiffs’ aider-and-abettor claims against Pring and Central Bank under § 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. To establish aider-and-abettor liability a plaintiff must prove (1) the existence of a primary violation of the securities laws by another;<sup>12</sup> (2) knowledge of the primary violation by the alleged aider-and-abettor; and (3) substantial assistance by the alleged aider-and-abettor in achieving the primary violation. *Farlow v. Peat, Marwick, Mitchell & Co.*, 956 F.2d 982, 986 (10th Cir. 1992); *accord K&S Partnership v. Continental Bank, N.A.*, 952 F.2d 971, 977 (8th Cir. 1991), *petition for cert. filed*, 60 U.S.L.W. 3755 (U.S. Apr. 22, 1992) (No. 91-1692); *Schatz v. Rosenberg*, 943 F.2d 485, 495 (4th Cir. 1991), *cert.*

<sup>11</sup> AmWest controlled AmWest L.P. as its sole general partner. AmWest’s chairman of the board, AmWest’s president, and another AmWest officer constituted the entire board of directors of the Authority and thus controlled it.

<sup>12</sup> Neither defendant argues that plaintiffs’ evidence fails to establish a material question of fact as to the existence of a primary violation, which relieves us of further inquiry on the first element.

*denied*, 112 S. Ct. 1475 (1992); *Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990).<sup>13</sup>

## A

Pring's motion for summary judgment was granted by the district court on the ground that "silence and inaction are not bases to establish substantial assistance absent an additional fiduciary duty to disclose." I R. tab 17 at 5. Plaintiffs do not contend that Pring owed them a duty to disclose. Rather, plaintiffs argue that Pring's silence and inaction, in

<sup>13</sup> Although the three elements seem to be universally accepted, some circuits state the second and third elements as a general awareness by the alleged aider-and-abettor that his or her role was part of an overall activity that was improper; and the alleged aider-and-abettor knowingly and substantially assisted the primary violation. See *Fine v. American Solar King Corp.*, 919 F.2d 290, 300 (5th Cir. 1990), *cert. dismissed*, 112 S. Ct. 576 (1991); *Schneberger v. Wheeler*, 859 F.2d 1477, 1480 (11th Cir. 1988), *cert. denied*, 490 U.S. 1091 (1989); *Moore v. Fenex, Inc.*, 809 F.2d 297, 303 (6th Cir.), *cert. denied*, 483 U.S. 1006 (1987); *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983); *Investors Research Corp. v. SEC*, 628 F.2d 168, 178 (D.C. Cir.), *cert. denied*, 449 U.S. 919 (1980). The Third Circuit has used both formulations. Compare *Landy v. FDIC*, 486 F.2d 139, 162-63 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974) with *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 799 (3d Cir.), *cert. denied*, 439 U.S. 930 (1978). The Seventh Circuit considers the three elements to be additional requirements beyond a showing that the alleged aider-and-abettor committed a proscribed "manipulative or deceptive" act with the same scienter as for primary liability. See, e.g., *Schlifke v. Seafirst Corp.*, 866 F.2d 935, 947 (7th Cir. 1989). Although the Ninth Circuit generally states the elements as in the text, a recent case expressly includes in the second element the alleged aider-and-abettor's reckless disregard of the wrong and his or her role in furthering it. See *Levine v. Diamanthuset, Inc.*, 950 F.2d 1478, 1483 (9th Cir. 1991).

light of what he knew about AmWest and the appraisal,<sup>14</sup> did constitute substantial assistance because Pring had actual intent to aid the primary violation.

When there is no duty to disclose, it is sometimes stated absolutely that silence or inaction cannot be the basis for aider-and-abettor liability. E.g., *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495-96 (7th Cir. 1986) ("When the nature of the offense is a failure to 'blow the whistle', the defendant must have a *duty* to blow the whistle."). The weight of authority, however, is that even absent a duty to disclose, silence and inaction can be substantial assistance for aider-and-abettor liability *provided* the defendant consciously intended to assist the primary violation. E.g., *Schneberger v. Wheeler*, 859 F.2d 1477, 1480 (11th Cir. 1988), *cert. denied*, 490 U.S. 1091 (1989); *Moore v. Fenex, Inc.*, 809 F.2d 297, 303-04 (6th Cir.), *cert. denied*, 483 U.S. 1006 (1987); *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 800 (3d Cir.), *cert. denied*, 439 U.S. 930 (1978); *Woodward v. Metro Bank*, 522 F.2d 84, 97 (5th Cir. 1975). For example, in *Metge* the court said that

in the absence of a duty to act or disclose, an aider-and-abettor case predicated on inaction of the secondary party must meet a high standard of intent. As applied here, *Woodward* and *Monsen* require that the aider-and-abettor's inaction be accompanied by actual knowledge of the underlying fraud and intent to aid and abet a wrongful act. The requisite intent

<sup>14</sup> The record makes clear that Pring knew that AmWest needed to buy additional land to use as collateral. Pring's own admissions support plaintiffs' contentions that he was aware of concerns regarding the appraisal and that an independent review would be delayed until after the bonds were issued. See I R. tab 13, ex. A at 114-16. Pring does not challenge the existence of a material question of fact as to the second element of aider-and-abettor liability, i.e., scienter. However, regarding the third element of substantial assistance, we assume that Pring does controvert the existence of conscious intent to assist the primary violation.



and knowledge may be shown by circumstantial evidence.

762 F.2d at 625. In evaluating whether silence was accompanied by a conscious or actual intent to assist the primary violation, courts have examined whether the alleged aider-and-abettor benefitted from such silence. *See, e.g., K&S Partnership*, 952 F.2d at 978; *Metge*, 762 F.2d at 629; *cf. DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir.) (on the issue of defendant's mental state, ask if "the defendant has thrown in his lot with the primary violators," e.g., did defendant have anything to gain (quoting *Barker*, 797 F.2d at 497) ), *cert. denied*, 111 S. Ct. 347 (1990); *Barker*, 797 F.2d at 497 ("If the plaintiff does not have direct evidence of scienter, the court should ask whether the fraud (or cover-up) was in the interest of the defendants."). This analysis is appropriate in this case.

Plaintiffs' evidence establishes that Pring had a substantial personal stake in the 1988 bond issue. Pring knew that he and his family would receive a substantial payment from AmWest L.P. from the proceeds of the 1988 bond sale.<sup>15</sup> Based on the record, a jury could find that Pring had a strong

<sup>15</sup> The February 24, 1988 letter from Timm to Pring indicates AmWest's plan to use \$725,000 in "Funds available from the Bond Issue" to purchase land from the Pring family. I R. tab 13, ex. E at 3. In his deposition, Pring acknowledged a May 17, 1988 letter from Timm that included "[a] summary of the bond closing payments to the Pring shareholders and limited partners." I R. tab 13, ex. A at 130. Furthermore, in a letter dated June 15, 1988, the day before the bond closing, AmWest gave Pring "a detailed listing of the amounts which AmWest is arranging to remit to you from the proceeds of our June 16th bonds closing," which indicated a grand total payment of \$1,965,932.08. I R. tab 13, ex. I. Although Pring's answers were somewhat hedged on the question of where the funds came from, *see* I R. tab 13, ex. A at 136-38, he admitted that the notation "Re-closing of 6/16/88" on the June 15 letter was in his handwriting, *id.* at 136, and the trier of fact could conclude that he in fact did know that the source of funds was the 1988 bond issue.

motivation to stay silent despite what he knew. Pring's possible motivation is in sharp contrast to the lesser motivations courts have held insufficient to show conscious intent. *See, e.g., DiLeo*, 901 F.2d at 629 (accountant's fees for two years of audits); *National Union Fire Ins. Co. v. Turtur*, 892 F.2d 199, 207 (2d Cir. 1989) (insurance company's premium for a guarantee). Viewing the evidence in the light most favorable to plaintiffs, the nonmoving parties on summary judgment, the trier of fact reasonably could conclude that Pring had a conscious intent to assist the alleged primary violation and that had Pring not stayed silent plaintiffs would not have suffered losses. Thus, there was a genuine issue of material fact as to the third element of substantial assistance and summary judgment on plaintiff's aiding-and-abetting claim against Pring was inappropriate.

## B

Central Bank's motion for summary judgment was granted by the district court on the ground that plaintiffs failed to raise a genuine issue as to the element of scienter. The district court determined that plaintiffs had not established a duty to disclose by Central Bank. Then, citing only *National Union Fire Ins. Co. v. Eaton*, 701 F. Supp. 1031 (S.D.N.Y. 1988), the district court concluded that without a duty to disclose, recklessness does not satisfy the scienter requirement for aider-and-abettor liability.

Central Bank argues that recklessness is not sufficient scienter because it had no duty to disclose. Without such a duty, Central Bank asserts, the required scienter is conscious intent, citing *Woodward, Ross, Monsen, and IIT v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980). Central Bank argues that it did not have conscious intent to assist the primary violation, and that in any event it did not substantially assist the primary violation. Plaintiffs' primary argument is that even without



a duty to disclose, recklessness is sufficient scienter. Plaintiffs contend that Central Bank acted recklessly by affirmatively agreeing to delay the independent review of the Hastings updated appraisal. Plaintiffs also assert that Central Bank did not provide substantial assistance to the primary violation.

We agree with Central Bank's argument and the district court's conclusion that Central Bank owed plaintiffs no duty to disclose. An indenture trustee's duties are strictly defined and limited to the terms of the indenture. *See, e.g., Elliott Assocs. v. J. Henry Schroder Bank & Trust Co.*, 838 F.2d 66, 71 (2d Cir. 1988). The Trust Indenture Act of 1939 expressly provides that "the indenture trustee shall not be liable except for the performance of such duties as are specifically set out in such indenture." 15 U.S.C. § 77000(a)(1). Section 9.01(a) of the indenture at issue here provided that the trustee at relevant times "undertakes to perform such duties and only such duties as are specifically set forth in this [i]ndenture." II Supp. R. 53.

But the lack of a duty to disclose is not dispositive in this case. As Central Bank concedes, the Trust Indenture Act of 1939 "does not affect 'the rights, obligations, duties [, or] liabilities of any person' under the federal securities laws." Answer Brief of Defendant-Appellee Central Bank at 29 (quoting 15 U.S.C. § 77zzz). It is clear that in a proper case it is possible for an indenture trustee to be held liable as an aider-and-abettor. *See Cronin*, 619 F.2d at 861-862 (reversing grant of summary judgment for defendant indenture trustees and remanding for further discovery despite the district court's belief "that the [trustees'] duties were limited by the terms of their indenture agreements"); *Lewis v. Marine Midland Grace Trust Co.*, 63 F.R.D. 39, 45-46 (S.D.N.Y. 1973) (denying defendants' motions to dismiss and indicating that if the elements of aiding-and-abetting liability are established the defendant indenture trustee can be liable); *cf. Ross v. Bank South, N.A.*, 837 F.2d 980, 1003 (11th Cir.) (implying

that an indenture trustee could be liable if plaintiffs had evidence, as opposed to just conclusory allegations, that the trustee had knowledge of the fraud), *vacated*, 848 F.2d 1132 (11th Cir. 1988), *on reh'g*, 885 F.2d 723 (11th Cir. 1989) (en banc), *cert. denied*, 495 U.S. 905 (1990). Thus, Central Bank is not immune from liability if plaintiffs can prove the elements of aider-and-abettor liability.

The established rule is that recklessness is sufficient scienter for a primary violation of § 10(b) and Rule 10b-5. *E.g., Hackbart v. Holmes*, 675 F.2d 1114, 1117 (10th Cir. 1982); *accord, e.g., Van Dyke v. Coburn Enters., Inc.*, 873 F.2d 1094, 1100 (8th Cir. 1989) ("[t]he majority rule in the Courts of Appeals is that recklessness satisfies th[e] scienter requirement"; citing cases from the Second, Third, Fifth, Seventh, Ninth, Eleventh and District of Columbia Circuits).<sup>16</sup> The Seventh Circuit has said that aiding-and-abetting liability requires "the same mental state [as] required for primary liability." *Barker*, 797 F.2d at 495. This circuit, in at least three cases involving claims of both primary and aiding-and-abetting liability, has indicated that recklessness is sufficient scienter without distinguishing between the claims. *See C.E. Carlson, Inc. v. SEC*, 859 F.2d 1429, 1435 (10th Cir. 1988); *Cronin v. Midwestern Okla. Dev. Auth.*, 619 F.2d 856, 862 (10th Cir. 1980); *Edward J. Mawod & Co. v. SEC*, 591 F.2d 588, 595-96 (10th Cir. 1979).

Several courts expressly have held that recklessness satisfies the scienter requirement for aiding-and-abetting liability. *See, e.g., Levine v. Diamanthuset, Inc.*, 950 F.2d 1478, 1483 (9th Cir. 1991) (including recklessness in the scienter element and citing cases); *FDIC v. First Interstate Bank*, 885

<sup>16</sup> Recklessness satisfied the scienter requirement for common law fraud. *See, e.g., Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1024 (6th Cir. 1979). Although negligence is not sufficient, the Supreme Court has left open the question of whether recklessness is sufficient scienter for a violation of § 10(b). *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 & n.12 (1976).

F.2d 423, 432-33 (8th Cir. 1989) (holding recklessness sufficient in a case predicated on action); *Dirks v. SEC*, 681 F.2d 824, 844-45 (D.C. Cir. 1982) (opinion of Wright, J.) (Two leading aiding-and-abetting cases "do not imply that 'knowingly \* \* \* assist' or 'general awareness' require a higher standard for aiding or abetting liability than the general scienter standard required by *Ernst & Ernst*. Recklessness would have been enough." (footnote omitted)), *rev'd on other grounds*, 463 U.S. 646 (1983). This court has said that "a proper showing of reckless conduct *might* satisfy [the] state of mind requirement" for aiding-and-abetting liability. *Decker v. SEC*, 631 F.2d 1380, 1388 & n.16 (10th Cir. 1980) (aiding-and-abetting claim under 15 U.S.C. § 17(e)(1)) (emphasis added).

Some courts, however, have indicated that recklessness is not sufficient scienter for aiding-and-abetting liability unless the defendant had a fiduciary duty. *See, e.g., Edwards & Hanly v. Wells Fargo Sec. Clearance Corp.*, 602 F.2d 478, 484 (2d Cir. 1979) ("We have not used the 'recklessness' standard when money damages are claimed in an aiding and abetting context, except on the basis of a breach of fiduciary duty."), *cert. denied*, 444 U.S. 1045 (1980).<sup>17</sup> *See generally* William H. Kuehnle, *Secondary Liability Under the Federal Securities Laws — Aiding and Abetting, Conspiracy, Controlling Person, and Agency: Common-Law Principles and the Statutory Scheme*, 14 J. Corp. L. 313, 327-30 (1989) (stating that while some courts have adopted recklessness as a general standard for aiding-and-abetting liability, many courts use a recklessness standard only in certain circumstances, including where there is a fiduciary duty); Don J. McDermott, Jr., Note, *Liability for Aiding and Abetting Violations of Rule 10b-5: The*

<sup>17</sup> We have quoted language from the Second Circuit that even if a defendant is reckless, "absent a fiduciary duty owing from [defendant] to [plaintiff] there is no aiding and abetting liability." *Farlow*, 956 F.2d at 987 (quoting *Ross*, 904 F.2d at 824). This quotation, however, was made during the course of a lengthy discussion of various cases, and *Farlow* did not adopt this view as the law of this circuit.

*Recklessness Standard in Civil Damage Actions*, 62 Tex. L. Rev. 1087, 1103-08 (1984) (same, finding the fiduciary duty requirement particularly clear in the Second Circuit, but indicating that some Second Circuit opinions have either hesitated to accept the requirement or have gone to great lengths to find some duty).

In this case Central Bank has mischaracterized plaintiffs' claim as one alleging that Central Bank improperly did not disclose certain facts. It is true that the primary violation alleged by plaintiffs includes the nondisclosure in the official statement of certain facts. It is also true that plaintiffs' aiding-and-abetting claim against Pring is based on the allegation that his silence and nondisclosure assisted the primary violation. But plaintiffs' claim against Central Bank is different. Plaintiffs allege that Central Bank assisted the primary violation by *affirmative action*, specifically by affirmatively agreeing to delay the independent review of the Hastings appraisal.<sup>18</sup>

Thus we arrive at the issue before us: when an alleged aider-and-abettor owes no duty to plaintiffs, but takes affirmative action that assists the primary violation, does recklessness satisfy the scienter requirement for aiding-and-abetting liability? In light of the affirmative nature of Central Bank's alleged assistance, the nondisclosure cases relied

<sup>18</sup> In the district court plaintiffs argued that Central Bank both affirmatively acted to delay the independent review of the Hastings appraisal and failed to alert plaintiffs of the risks related to the Hastings appraisal. I R. tab 1 at 13-14 (complaint); I R. tab 12 at 1 (brief opposing motion for summary judgment (emphasizing "affirmative steps")). The district court's order only deals with plaintiffs' claim of affirmative acts. Furthermore, on appeal, plaintiffs appear to have abandoned the argument that Central Bank improperly was silent. *See* Reply Brief for the Plaintiffs-Appellants at 23 ("Central characterizes plaintiffs' showing as nothing more than an argument that Central passively failed to 'blow the whistle' on the Hastings appraisal. Central says it did not have a duty to be a whistle blower. But this is distinctly not plaintiffs' argument.").



on by Central Bank are inapposite. Central Bank asserts that "[t]here is simply no decision in this Circuit or any other which imposes aider and abettor liability upon a finding of recklessness where there is not also a breach of a duty to disclose." Answer Brief of Defendant-Appellee Central Bank at 22. However, such cases do exist, and they are the ones that are relevant here.

The Ninth Circuit's recent opinion in *Levine* is particularly enlightening. In that case the court addressed the potential liability of a trust company and a bank as aiders-and-abettors of an allegedly fraudulent diamond investment scheme. 950 F.2d at 1483-85. The trust company allegedly assisted the primary violation by, inter alia, allowing its name to be used in promotional materials, accepting telephone inquiries from investors, and issuing confirmations to investors. *Id.* at 1484. The bank allegedly assisted the primary violation by, inter alia, sending an officer to certain seminars, coordinating the handling of investor inquiries, making certain representations to investors, and considering but apparently not making an amendment to a deposit agreement to conform to certain representations. *Id.* at 1485. Of course, the facts in the instant case are different. Importantly, however, the *Levine* court considered the case before it as one based on assistance by action and for that reason expressly found irrelevant the question whether the alleged aiders-and-abettors had a duty to disclose. *See id.* at 1484-85 nn.4-5. Further, in holding that the plaintiff's allegations adequately stated claims for aiding-and-abetting liability, the court applied a recklessness standard. *See id.* at 1484 (the trust company's actions "may well have been reckless — that is, highly unreasonable and constituting an extreme departure from standards of ordinary care"); *id.* at 1485 (plaintiff "could prove facts indicating [the bank's] reckless disregard, if not actual knowledge, of both [the primary violations] and the bank's role in the violations").

The Eighth Circuit also has applied a recklessness standard in an aiding-and-abetting case the court described as one "predicated on action." *First Interstate Bank*, 885 F.2d at 429, 432-33 (applying *Metge*, 762 F.2d at 621, to a case of common law aiding-and-abetting). In *First Interstate Bank*, despite various warnings and significant concerns about a particular customer, the defendant bank assisted the customer's fraud by processing accounts, handling wire transfers, and reversing a decision to require the customer to close his accounts. *See id.* at 424-28. The jury found the bank liable as an aider-and-abettor. *See id.* at 428. In affirming the denial of a motion for judgment n.o.v., the court said the "evidence supports an inference that [the defendant bank], with potential profits in mind, recklessly chose to continue its relationship with [the primary violator]." *Id.* at 432. The defendant bank made the argument — essentially the same argument put forth by Central Bank — that it had no fiduciary duty and therefore it could not be held liable for inaction without a showing of more than recklessness. *See id.* at 432-33. The Eighth Circuit rejected this argument, noting that this was "a case predicated on action" and stating that "[i]t need not be shown, therefore, that [the defendant bank] consciously intended to defraud the [plaintiff]." *Id.* at 433.

The cases discussed above reject the idea that the scienter element for aiding-and-abetting liability cannot be satisfied by recklessness without a duty to disclose. We also reject that view. We hold that in an aiding-and-abetting case based on assistance by action, the scienter element is satisfied by recklessness.

"[R]eckless behavior is conduct that is 'an extreme departure from the standards of ordinary care, and which presents a danger . . . that is either known to the defendant or is so obvious that the actor must have been aware of it.'" *Hackbart*, 675 F.2d at 1118 (citation omitted); *accord, e.g., Hollinger*, 914 F.2d at 1569. We turn to the facts of this case, viewed in the light most favorable to plaintiffs, to determine



whether the trier of fact reasonably could conclude that Central Bank was reckless when it agreed to delay the independent review of the Hastings updated appraisal.

Central Bank appears to argue that this was simply a "transaction[] constituting the daily grist of the mill." *Woodward*, 522 F.2d at 97. But the evidence supports the inference that this was not an ordinary transaction. Central Bank's own trust officer and others characterized this as a complicated transaction. See I R. tab 12, ex. G at 454; I R. tab 12, ex. B at 161. Central Bank's in-house appraiser indicated that this was the only situation in which he had been asked to review an appraisal of collateral for a bond issue. See I R. tab 12, ex. J at 46. Before the agreement to delay the independent review, one of Central Bank's vice-presidents assumed responsibility for the transaction from the trust officer who had been handling it. See I R. tab 12, ex. B at 161. Nothing in the record suggests that in any other situation had Central Bank first decided to require an independent review of an appraisal for a bond issue and later agreed to delay it.

Central Bank argues that the agreement to delay the independent review was justified in part because it was entitled to rely on the certifications provided by the Authority and Hastings. The indenture does contain provisions to that effect. But the issue is whether agreeing to delay the independent review was an extreme departure from the standards of ordinary care that carried a known or obvious danger, not whether it was a breach of authority under the indenture. As to Central Bank's reliance on the Authority's certifications, it is significant that Central Bank previously had been warned expressly that the Authority may have "given false or misleading certifications." I R. tab 12, ex. G at 455. As to Hastings's certification, the fact that Central Bank apparently prepared a draft of it, see II Supp. R. tab 75, and it was not executed until June 16 (the date of the bond closing),

suggest that it was given little weight in Central Bank's decision to agree to delay the independent review.

Before the agreement to delay the independent review, it is undisputed that Central Bank knew that serious concerns had been raised about the accuracy of the Hastings updated appraisal. Central Bank's own action, in originally requiring an independent review, demonstrates that it believed that those concerns were credible. As a condition to postponing the independent review of the Hastings updated appraisal, Central Bank did require that approximately \$2 million worth of additional property be added to the security for the 1986 bond issue. This may have alleviated concerns about insufficient security for the 1986 bonds, but it did nothing to address the danger that the collateral was deficient for the 1988 bonds. Although the bank's duty at that time was only with respect to the 1986 bond issue, the bank was preparing to be the indenture trustee for the 1988 bond issue. Central Bank knew that the sale of the 1988 bonds was imminent, and apparently knew that the Hastings updated appraisal was being relied on to value the collateral for the 1988 bonds. Under these circumstances, the bank's knowledge of the alleged inadequacies of the Hastings updated appraisal could support a finding of extreme departure from the standards of ordinary care.

The above are all of the facts we can discern from the record before the court for summary judgment. Although a trial might shed more light on the reasons for Central Bank's actions, and that might justify the bank's exoneration, on the basis of the record before us we hold that plaintiffs have established a genuine issue of material fact as to the scienter element of aiding-and-abetting liability.<sup>19</sup>

<sup>19</sup> In addition to arguing that Central Bank was reckless, plaintiffs argue alternatively that Central Bank had actual knowledge of the primary violation. Because of our disposition, we need not reach this issue.

The third element of substantial assistance was not addressed by the district court.<sup>20</sup> Plaintiffs argue that Central Bank's agreement to delay an independent review of the Hastings appraisal constituted substantial assistance to the primary violation. Central Bank argues that although it had the *right* to require an independent review it was not required to do so under the indenture. This simply establishes that Central Bank did not breach a duty under the indenture. On the separate question of whether Central Bank rendered substantial assistance to the primary violation, which allegedly included representing the Hastings appraisal as accurate, the trier of fact reasonably could conclude that had Central Bank adhered to its original demand for an independent review and not agreed to delay it, the depleted collateral would have been discovered and plaintiffs' losses avoided. Thus, we hold that plaintiffs have raised a genuine issue of material fact as to the element of substantial assistance, and the district court's grant of summary judgment for Central Bank was inappropriate.

REVERSED and REMANDED for proceedings consistent herewith.

<sup>20</sup> Central Bank argues that plaintiffs "absolutely ignored" the element of substantial assistance in the district court. Although plaintiffs' brief opposing summary judgment focused on the scienter element it cited the substantial assistance element and specifically referred to the agreement to delay the independent review of the appraisal. Any suggestion that plaintiffs failed to preserve the substantial assistance issue is without merit.

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLORADO

Civil Action No. 89-F-1250 and  
Civil Action No. 89-F-1806

FIRST INTERSTATE BANK OF DENVER, N.A., and  
JACK K. NABER,

*Plaintiffs,*

vs.

KIRCHNER MOORE & COMPANY, d/b/a DBLKM Inc.;  
HANIFEN IMHOFF, INC.;  
THE COLORADO SPRINGS-STETSON HILLS PUBLIC BUILDING  
AUTHORITY;  
ROY I. PRING; and  
THE CENTRAL BANK & TRUST COMPANY OF DENVER,

*Defendants,*

and

KIRCHNER MOORE & COMPANY, d/b/a DBLKM Inc.,  
*Third-Party Plaintiff,*

vs.

RESOLUTION TRUST CORPORATION, as Conservator for Cap-  
itol Federal Savings and Loan Association of Denver;  
AMWEST DEVELOPMENT CORP.;  
AMWEST DEVELOPMENT I LIMITED PARTNERSHIP; and

*Third-Party Defendants.*



## ORDER ON MOTIONS FOR SUMMARY JUDGMENT

Sherman G. Finesilver, Chief Judge

THIS MATTER comes before the court on various motions of parties. This litigation arises from the alleged fraudulent issuance and sale of bonds in violation of federal securities law. Plaintiffs bring this cause of action pursuant to § 10(b) of the Securities Exchange Act of 1934 and rules promulgated thereunder by the Securities Exchange Commission. 15 U.S.C. § 78a *et seq.* Jurisdiction arises pursuant to 28 U.S.C. § 1331. The factual and procedural background of this litigation has been outlined in prior orders and will not be repeated here.

Three motions for summary judgment have been filed pursuant to Fed.R.Civ.P. 56. Defendant Roy I. Pring moves for summary judgment of claims of plaintiffs First Interstate Bank of Denver, N.A. and Jack K. Naber. Defendant Central Bank & Trust Company of Denver moves for summary judgment of plaintiffs' claim. Third-party defendant Resolution Trust Corporation as Conservator for Capitol Federal Savings and Loan Association of Denver moves for summary judgment of third-party claim of defendant and third-party plaintiff Kirchner Moore & Company.

### I.

Summary judgment is proper where there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(c); *Willner v. Budig*, 848 F.2d 1032, 1033-34 (10th Cir.), *cert. denied*, \_\_\_U.S. \_\_\_, 109 S.Ct. 840 (1989). The plain language of Rule 56(c) mandates the entry of summary judgment against the party who fails to make a showing that is sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial.

*Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). In reviewing a motion for summary judgment, the court must view the evidence in the light most favorable to the party opposing the motion, and resolve all doubts in favor of the existence of triable issues of fact. *World of Sleep, Inc. v. La-Z-Boy Chair Co.*, 756 F.2d 1467, 1474 (10th Cir.), *cert. denied*, 474 U.S. 823 (1985); *Ross v. Hilltop Rehabilitation Hosp.*, 676 F.Supp. 1528 (D. Colo. 1987).

In *Celotex v. Catrett*, 477 U.S. 317 (1986), the Supreme Court held that the language of Rule 56(c) does *not* require the moving party to show an *absence* of issues of material fact in order to be awarded summary judgment. *Id.*, 477 U.S. at 322. The movant merely has the initial responsibility of informing the court of the basis for the motion, and identifying those portions of the record it believes show a lack of genuine issue. *Id.*, 477 U.S. at 323. This burden is discharged merely by pointing out to the court there is an absence of evidence to support the non-movant's case. *Id.*, 477 U.S. at 325. On the other hand, the non-movant has the burden of showing that there *are* issues of material fact to be determined. *Id.*, 477 U.S. at 322-23. See Childress, *A New Era for Summary Judgments: Recent Shifts at the Supreme Court*, 116 F.R.D. 183 (1987).

### II.

Defendant Roy I. Pring ("Pring") moves for summary judgment of claims of plaintiffs First Interstate Bank of Denver, N.A. and Jack K. Naber (the "plaintiffs"). Plaintiffs contend Pring is (1) primarily liable under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities Exchange Commission and is (2) secondarily liable as (a) participant in conspiracy to commit fraud under Rule 10b-5; (b) controlling person under § 20 of the Securities Exchange Act; and (c) aider and abettor under Rule 10b-5.



Plaintiffs fail to oppose Pring's motion as to primary liability and as to conspiracy liability.

In order to establish liability of Pring as controlling person pursuant to § 20 of the Securities Exchange Act plaintiffs must prove the purported controlling person (1) actively participated in overall management and operation of the controlled entity and (2) actively participated, in some meaningful sense, in the fraud perpetrated by that entity. *Harrison v. Enventure Capital Group, Inc.*, 666 F.Supp. 473, 478 (W.D.N.Y. 1987); *Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973) (*en banc*). Pring correctly states plaintiffs must offer evidence that Pring controlled the developer, AmWest I Development Limited Partnership ("AmWest"), and participated in a fraud committed by the developer or the issuer of the Bonds, the Colorado Springs-Stetson Hills Public Building Authority. In opposition plaintiffs state Pring owned or controlled the collateral property, was a substantial interest holder in AmWest and was a principal creditor of AmWest. Pring was a creditor of AmWest. His last loan to AmWest was made in 1985. Pring was no longer an officer of AmWest when the Official Statement was prepared or when the Bonds were issued. Even taken as true plaintiffs' evidence fails to establish that Pring actually participated in the alleged fraud of the developer or the issuer of the Bonds. *Seattle-First National Bank v. Carlstedt*, 678 F.Supp. 1543 (W.D.Okla. 1987). There is no genuine issue of material fact in regard to active participation in the alleged fraud in order to establish controlling person liability.

In order to establish aider and abettor liability under Rule 10b-5 plaintiff must prove (1) primary violation of Rule 10b-5 by another; (2) knowledge of the violation by alleged aider and abettor; and (3) substantial assistance by the aider and abettor. *Feldman v. Pioneer Petroleum, Inc.*, 606 F.Supp. 916 (W.D.Okla. 1985), *aff'd*, 813 F.2d 296 (10th Cir. 1987); *Johnson v. Chilcott*, 658 F.Supp. 1213 (D.Colo. 1987). Plaintiffs contend Pring's silence and inaction in the

face of undervalued collateral constitute substantial assistance to establish liability as aider and abettor. However silence and inaction are not bases to establish substantial assistance absent an additional fiduciary duty to disclose. *Dirks v. SEC*, 463 U.S. 646, 653-64 (1983); *Chiarella v. United States*, 445 U.S. 222, 227-35 (1980). Plaintiffs fail to offer persuasive authority or evidence to establish that Pring breached any fiduciary duty owed plaintiffs. Plaintiffs fail to establish a material fact as to the third element necessary for aider and abettor liability.

### III.

Defendant Central Bank & Trust Company of Denver ("CBD") moves for summary judgment of plaintiffs' claim against CBD. Plaintiffs contend Central Bank is secondarily liable under Section 10(b) of the Securities Exchange Act and Rule 10b-5 of the Securities Exchange Commission as aider and abettor. The elements of aider and abettor liability are identified above.

Plaintiffs allege CBD knowingly took affirmative steps to postpone review of the so-called Hastings appraisal, a key element in the alleged scheme to defraud. Plaintiffs contend this was reckless behavior by CBD, thereby satisfying the knowledge or scienter requirement of aider and abettor liability. However the scienter requirement may not be satisfied by showing recklessness absent an additional duty to disclose. *National Union Fire Ins. Co. of Pittsburgh v. Eaton*, 701 F.Supp. 1031 (S.D.N.Y. 1988). Plaintiffs do not raise a genuine issue of material fact as to CBD's knowledge of fraud allegedly perpetrated by AmWest or as to additional duty to disclose owed by CBD.

### IV.

Third-party defendant Resolution Trust Corporation ("RTC") as Conservator for Capitol Federal Savings and

Loan Association of Denver ("Capitol Federal") moves for summary judgment of third-party claim of defendant and third-party plaintiff Kirchner Moore & Company ("KMC"). KMC brings a claim for contribution, based on Capitol Federal's liability under § 10b and Rule 10b-5 as an aider and abettor. The elements of aider and abettor liability are identified above. KMC has not presented evidence to establish Capitol Federal, at the time it lent an additional \$1.5 million to AmWest, had any knowledge of fraud allegedly committed by AmWest or any other entity. The scienter requirement for aider and abettor liability may not be satisfied by showing recklessness absent an additional duty to disclose. *National Union Fire Ins. Co. of Pittsburgh v. Eaton*, 701 F.Supp. 1031 (S.D.N.Y. 1988). KMC does not raise a genuine issue of material fact in regard to Capitol Federal's knowledge of the alleged fraud or as to a duty to disclose.

## V.

Defendants Central Bank, Hanifen Imhoff, Inc. and Roy I. Pring have filed a motion to compel depositions of plaintiffs' expert witnesses. However the deadline for completion of discovery has passed. The motion to compel is denied.

## VI.

ACCORDINGLY IT IS ORDERED that the motion of Roy I. Pring for leave to file reply brief in excess of ten pages, filed June 20, 1990, is GRANTED. The reply brief is deemed filed through. Plaintiffs' motion for leave to submit supplemental memorandum respecting Pring's motion for summary judgment, filed June 21, 1990, is GRANTED. The supplemental memorandum is deemed filed through.

IT IS FURTHER ORDERED that the motion of RTC for leave to file reply brief in excess of ten pages, filed June 20, 1990, is GRANTED. The reply brief is deemed filed through.

IT IS FURTHER ORDERED that the motion for summary judgment of Roy I. Pring pursuant to Fed.R.Civ.P. 56 is GRANTED. The Clerk of the Court is DIRECTED to enter judgment in favor of defendant Roy I. Pring and against plaintiffs First Interstate Bank of Denver, N.A. and Jack K. Naber.

IT IS FURTHER ORDERED that the motion for summary judgment of Central Bank & Trust Company of Denver pursuant to Fed.R.Civ.P. 56 is GRANTED. The Clerk of the Court is DIRECTED to enter judgment in favor of Central Bank & Trust Company of Denver and against plaintiffs First Interstate Bank of Denver, N.A. and Jack K. Naber.

IT IS FURTHER ORDERED that the motion for summary judgment of Resolution Trust Corporation as Conservator for Capitol Federal Savings and Loan Association of Denver pursuant to Fed.R.Civ.P. 56 is GRANTED. The Clerk of the Court is DIRECTED to enter judgment in favor of third-party defendant Resolution Trust Corporation as Conservator for Capitol Federal Savings and Loan Association of Denver and against defendant and third-party plaintiff Kirchner Moore & Company.

IT IS FURTHER ORDERED that the motion to compel of defendants Central Bank, Hanifen Imhoff, Inc. and Roy I. Pring, filed June 21, 1990, is DENIED.

IT IS FURTHER ORDERED that remaining parties are DIRECTED to file a Second Amended Pretrial Order on or before noon on July 5, 1990. Counsel for plaintiffs are DIRECTED to take the lead in preparation of the Pretrial Order. All counsel are DIRECTED to ensure that the Pretrial Order accurately reflects all remaining viable claims of parties and is complete in all respects.

The court strongly discourages pretrial motions. Evidentiary matters will be addressed at trial.

The court is in receipt of KMC's Notice of Name Change, filed June 25, 1990. The caption shall reflect Kirchner Moore & Company is now doing business as DBLKM Inc.

Done this 26th day of June 1990 at Denver, Colorado.

By the Court:

/s/ Sherman G. Finesilver

Sherman G. Finesilver,  
Chief Judge  
United States District Court

**Code of Federal Regulations, Title 17 (1989)**

**§ 240.10b-5.** Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

**U.S. Code, Title 15 (1988)**

**§ 77000. Duties and responsibility of trustee.**

**(a) Duties prior to default.**

The indenture to be qualified may provide that, prior to default (as such term is defined in such indenture)—

(1) the indenture trustee shall not be liable except for the performance of such duties as are specifically set out in such indenture; and

(2) the indenture trustee may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, in the absence of bad faith on the part of such trustee, upon certificates or opinions conforming to the requirements of the indenture;



but such indenture shall contain provisions requiring the indenture trustee to examine the evidence furnished to it pursuant to section 77nnn of this title to determine whether or not such evidence conforms to the requirements of the indenture.

**(b) Notice of defaults.**

The indenture to be qualified shall contain provisions requiring the indenture trustee to give to the indenture security holders, in the manner and to the extent provided in subsection (c) of section 77mmm of this title, notice of all defaults known to the trustee, within ninety days after the occurrence thereof: *Provided*, That such indenture may provide that, except in the case of default in the payment of the principal of or interest on any indenture security, or in the payment of any sinking or purchase fund installment, the trustee shall be protected in withholding such notice if and so long as the board of directors, the executive committee, or a trust committee of directors and/or responsible officers, of the trustee in good faith determine that the withholding of such notice is in the interests of the indenture security holders.

**(c) Duties of trustee in case of default**

The indenture to be qualified shall contain provisions requiring the indenture trustee to exercise in case of default (as such term is defined in such indenture) such of the rights and powers vested in it by such indenture, and to use the same degree of care and skill in their exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs.

**(d) Responsibility of trustee**

The indenture to be qualified shall not contain any provisions relieving the indenture trustee from liability for its

own negligent action, its own negligent failure to act, or its own willful misconduct, except that—

(1) such indenture may contain the provisions authorized by paragraphs (1) and (2) of subsection (a) of this section;

(2) such indenture may contain provisions protecting the indenture trustee from liability for any error of judgment made in good faith by a responsible officer or officers of such trustee, unless it shall be proved that such trustee was negligent in ascertaining the pertinent facts; and

(3) such indenture may contain provisions protecting the indenture trustee with respect to any action taken or omitted to be taken by it in good faith in accordance with the direction of the holders of not less than a majority in principal amount of the indenture securities at the time outstanding (determined as provided in subsection (a) of section 77ppp of this title) relating to the time, method, and place of conducting any proceeding for any remedy available to such trustee, or exercising any trust or power conferred upon such trustee, under such indenture.

**(e) Undertaking for costs**

The indenture to be qualified may contain provisions to the effect that all parties thereto, including the indenture security holders, agree that the court may in its discretion require, in any suit for the enforcement of any right or remedy under such indenture, or in any suit against the trustee for any action taken or omitted by it as trustee, the filing by any party litigant in such suit of an undertaking to pay the costs of such suit, and that such court may in its discretion assess reasonable costs, including reasonable attorney's fees, against any party litigant in such suit, having the due regard to the merits and good faith of the claims or defenses made by such party litigant; *Provided*, That the provisions of this

subsection shall not apply to any suit instituted by such trustee, to any suit instituted by any indenture security holder, or group of indenture security holders, holding in the aggregate more than 10 per centum in principal amount of the indenture securities outstanding, or to any suit instituted by any indenture security holder for the enforcement of the payment of the principal of or interest on any indenture security, on or after the respective due dates expressed in such indenture security.

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THE COLORADO SPRINGS-STETSON HILLS  
PUBLIC BUILDING AUTHORITY,

- A Nonprofit Corporation Organized Under the  
Laws of the State of Colorado,

AND

THE CENTRAL BANK AND TRUST COMPANY OF DENVER,  
D/B/A CENTRAL BANK OF DENVER,  
A BANKING CORPORATION,  
as trustee

\_\_\_\_\_  
INDENTURE OF TRUST  
\_\_\_\_\_

Dated as of May 15, 1988

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## ARTICLE IX THE TRUSTEE

Section 9.01. *Acceptance of Trusts.* The Trustee hereby accepts the trusts imposed upon it by this Indenture, and agrees to perform said trusts, but only upon and subject to the following express terms and conditions:

(a) The Trustee, prior to the occurrence of an Event of Default and after the curing of all Events of Default which may have occurred, undertakes to perform such duties and only such duties as are specifically set forth in this Indenture. In case an Event of Default has occurred (which has not been cured or waived), the Trustee shall exercise such of the rights and powers vested in it by this Indenture, and use the same degree of care and skill in the exercise of such rights and powers as an ordinary, prudent man would exercise or use under the circumstances in the conduct of his own affairs; provided, however, that the Trustee shall be entitled to reasonable reliance upon an opinion of counsel as set forth in subsection (b) below.

(b) The Trustee may execute any of the trusts or powers hereof and perform any of its duties by or through attorneys, agents, receivers or employees, but shall be answerable for the conduct of the same in accordance with the standard specified above, and shall be entitled to reasonably rely upon the advice of counsel to the Trustee concerning all matters of trust hereof and the duties hereunder, and may in all cases pay such reasonable compensation to all such attorneys, agents, receivers and employees as may reasonably be employed in connection with the trusts hereof. The Trustee may act upon the opinion or advice of any attorney (who may be the attorney or attorneys for the Authority or the Company) approved by the Trustee in the exercise of reasonable care. The Trustee shall not be responsible for any loss or damage resulting

from any action or inaction in good faith in reliance upon such opinion or advice.

(c) The Trustee shall not be responsible for any recital herein or in the Bonds (except with respect to the certificate of the Trustee endorsed on the Bonds), or for the recording or re-recording, filing or re-filing of this Indenture, or for the validity of the execution by Authority of this Indenture, or any supplements hereto or instruments of further assurance, or for the sufficiency of the security for the Bonds issued hereunder or intended to be secured hereby.

(d) The Trustee shall not be accountable for the use of any Bonds authenticated or delivered hereunder. The Trustee may become the owner of Bonds secured hereby with the same rights which it would have if not the Trustee.

(e) The Trustee shall be protected in acting upon any notice, request, consent, certificate, order, affidavit, letter, telegram or other paper or document believed to be genuine and correct and to have been signed or sent by the proper Person or Persons. Any action taken by the Trustee pursuant to this Indenture upon the request or authority or consent of any Person who at the time of making such request or giving such authority or consent is the owner of any Bond shall be conclusive and binding upon all future owners of the same Bond and upon Bonds issued in exchange therefor or in place thereof.

(f) As to the existence or nonexistence of any fact or as to the sufficiency or validity of any instrument, paper or proceeding, the Trustee shall be entitled to rely upon a certificate signed by the Authority Representative or the Company Representative as sufficient evidence of the facts therein contained and prior to the occurrence of a Default of which the Trustee has been notified as provided in Section 9.01 (h) hereof, or of which by Section 9.01 (h) it is



deemed to have notice, shall also be at liberty to accept a similar certificate to the effect that any particular dealing, transaction or action is necessary or expedient, but may at its discretion secure such further evidence deemed by it to be necessary or advisable, but shall in no case be bound to secure the same. The Trustee may accept a certificate of such officials of the Authority who executed the Bonds (or their successors in office) under the seal of the Authority to the effect that a resolution in the form therein set forth has been adopted by the Authority as conclusive evidence that such resolution has been duly adopted and is in full force and effect.

(g) The permissive right of the Trustee to do things enumerated in this Indenture shall not be construed as a duty, and the Trustee shall not be answerable for other than its negligence or willful default.

(h) The Trustee shall not be required to take notice or be deemed to have notice of any Default hereunder except (i) failure by the Authority to cause to be made any of the payments to the Trustee required to be made by Article IV hereof and (ii) failure by the Authority or the company to file with the Trustee any document required by this Indenture or the Development Agreement or the Public Improvements Assessment and Lien to be so filed subsequent to the issuance of the Bonds, unless the Trustee shall be specifically notified in writing of such Default by the Authority or by the owners of at least twenty-five percent (25%) in aggregate principal amount of Outstanding Bonds, and all notices or other instruments required by this Indenture to be delivered to the Trustee, must, in order to be effective, be delivered at the principal corporate trust office of the Trustee, and in the absence of such notice so delivered the Trustee may conclusively assume there is no Default except as aforesaid.

(i) At any and all reasonable times the Trustee, and its duly authorized agents, attorneys, experts, engineers,

accountants and representatives, shall have the right fully to inspect any and all of the property herein conveyed, including all books and records of the Authority pertaining to the collection of Allocated Assessment Charges and the construction of the Improvements, and to take such memoranda from and with regard thereto as may be desired.

(j) The Trustee shall not be required to give any bond or surety in respect of the execution of the said trusts and powers or otherwise in respect of the premises.

(k) Notwithstanding anything elsewhere in this Indenture with respect to the authentication of any Bonds, the withdrawal of any cash, the release of any property or any action whatsoever within the purview of this Indenture, the Trustee shall have the right, but shall not be required, to demand any showings, certificates, opinions, appraisals or other information, or corporate action or evidence thereof, in addition to that by the terms hereof required as a condition of such action, by the Trustee deemed desirable for the purpose of establishing the right of the Authority to the authentication of any Bonds, the withdrawal of any cash or the taking of any other action by the Trustee.

(l) Before taking the action referred to in Section 8.03 or 8.08 hereof, the Trustee may require that a satisfactory indemnity bond be furnished for the reimbursement of all expenses to which it may be put and to protect it against all liability, except liability which is adjudicated to have resulted from its negligence or willful default in connection with any such action.

(m) All moneys received by the Trustee shall, until used or applied or invested as herein provided, be held in trust for the purposes for which they were received, but need not be segregated from other funds except to the extent required by law.

(n) No provision in this Indenture shall require the Trustee to expend or risk its capital or its own funds or to

incur any financial liability in the exercise of its rights and powers and duties as Trustee under this Indenture.

Section 9.02 *Fees, Charges and Expenses of the Trustee and Paying Agents.* The Trustee shall be entitled to receive, as an inception fee, the sum designated by the Authority from moneys on deposit in the Cost of Issuance Account. The Trustee and any Paying Agents shall also be entitled to payment and reimbursement for reasonable fees for their services rendered hereunder and all advances, counsel fees and other expenses reasonably and necessarily made or incurred by the Trustee in connection with such services solely from moneys made available as permitted by Section 5.09(b) hereof. Upon an Event of Default, but only upon an Event of Default, the Trustee shall have a first lien with right of payment prior to payment on account of principal of, premium, if any, and interest on any Bond upon the Trust Estate for the foregoing fees, charges and expenses incurred by the Trustee.

Section 9.03. *Notice to Bondholders if Default Occurs.* If a Default occurs of which the Trustee is by Section 9.01(h) hereof required to take notice or if notice of Default be given as therein provided, then the Trustee shall promptly give written notice thereof by registered or certified mail to the owner of each Bond shown by the list of Bondholders required by the terms of Section 4.06 hereof to be kept at the principal corporate trust office of the Trustee.

Section 9.04. *Intervention by the Trustee.* In any judicial proceeding to which the Authority or the Company is a party and which in the opinion of the Trustee and its counsel has a substantial bearing on the interests of owners of the Bonds, the Trustee may intervene on behalf of Bondholders and shall do so if requested in writing by the owners of at least twenty-five percent (25%) of the aggregate principal amount of Outstanding Bonds.

Section 9.05. *Successor Trustee.* Any corporation or association into which Trustee may be converted or merged, or with which it may be consolidated, or to which it may sell or transfer its trust business and assets as a whole or substantially as a whole, or any corporation or association resulting from any such conversion, sale, merger, consolidation or transfer to which it is a party, shall be and become successor Trustee hereunder and vested with all of the title to the Trust Estate and all the trusts, powers, discretions, immunities, privileges and all other matters as was its predecessor, without the execution or filing of any instrument or any further act, deed or conveyance on the part of any of the parties hereto, anything hereto to the contrary notwithstanding.

Section 9.06. *Resignation by the Trustee.* The Trustee and any successor Trustee may at any time resign from the trusts hereby created by giving thirty (30) days' written notice by registered or certified mail to the Authority and to the owner of each Bond as shown by the list of Bondholders required by Section 4.06 hereof to be kept by the Trustee, and such resignation shall not take effect until the appointment of a successor Trustee by the Bondholders or by the Authority.

Section 9.07. *Removal of the Trustee.* The Trustee may be removed at any time by an instrument or concurrent instruments in writing delivered to the Trustee and to the Authority and signed by the owners of a majority in aggregate principal amount of Outstanding Bonds.

Section 9.08. *Appointment of Successor Trustee by Bondholders.* In case the Trustee hereunder shall resign or be removed, or be dissolved, or shall be in course of dissolution or liquidation, or otherwise become incapable of acting hereunder, or in case it shall be taken under the control of any public officer or officers, or of a receiver appointed by a court, a successor may be appointed by the owners of a majority in aggregate principal amount of Outstanding Bonds by an instrument or concurrent instruments in writing signed by



such owners, or by their attorneys in fact duly authorized, a copy of which shall be delivered personally or sent by registered mail to the Authority. In case of any such vacancy, the Authority, by an instrument executed, attested and sealed by those of its officials who executed and attested the Bonds, may appoint a temporary Trustee to fill such vacancy until a successor Trustee shall be appointed by the Bondholders in the manner above provided; and such temporary trustee so appointed by the Authority shall immediately and without further act be superseded by the trustee appointed by the Bondholders; provided, however, that in the event the temporary trustee appointed by the Authority shall not be superseded by a trustee appointed by the Bondholders within six (6) months from the effective date of appointment by the Authority, the right of Bondholder to appoint a successor trustee shall be deemed to be waived and the trustee appointed by the Authority shall be deemed to be the Trustee hereunder. Notice of the appointment of a successor Trustee shall be given in the same manner as provided in Section 9.06 hereof with respect to the resignation of a Trustee. Every such Trustee appointed pursuant to the provisions of this Section shall be a trust company or bank in good standing having a reported capital and surplus of not less than \$10,000,000 if there be such an institution willing, qualified and able to accept the trust upon customary terms.

Section 9.09. *Concerning Any Successor Trustee.* Every successor Trustee appointed hereunder shall execute, acknowledge and deliver to its or his predecessor and also to the Authority and the Company an instrument in writing accepting such appointment hereunder, and thereupon such successor, without any further act, deed or conveyance, shall become fully vested with all the estates, properties, rights, powers, trusts, duties and obligations of its predecessor; but such predecessor shall, nevertheless, on the written request of the Authority, or of its successor, execute and deliver an instrument transferring to such successor all the estates, properties, rights, powers and trusts of such predecessor

hereunder; and every predecessor the Trustees shall deliver all securities and moneys held by it as the Trustee hereunder to its successor. Should any instrument in writing from the Authority be required by any successor Trustee for more fully and certainly vesting in such successor the estate, rights, powers and duties hereby vested or intended to be vested in the predecessor, any and all such instruments in writing shall, on request, be executed, acknowledged and delivered by the Authority. The resignation of any Trustee and the instrument or instruments removing any Trustee and appointing a successor hereunder, together with all other instruments provided for in this Article, shall be filed or recorded by the successor Trustee in each recording office where the Indenture shall have been filed or recorded.

Section 9.10. *Appointment of Co-Trustee.* It is the purpose of this Indenture that there shall be no violation of any law of any jurisdiction (including particularly the law of the State) denying or restricting the right of banking corporations or associations to transact business as the Trustee in such jurisdiction. It is recognized that in case of litigation under this Indenture or foreclosure under the Public Improvements Assessment and Lien, and in particular in case of the enforcement of any such instruments on Default, or in case the Trustee deems that by reason of any present or future law of any jurisdiction it may not exercise any of the powers, rights or remedies herein granted to the Trustee or hold title to the properties, in trust, as granted herein or in the Public Improvements Assessment and Lien, or take any other action which may be desirable or necessary in connection therewith, it may be necessary that the Trustee appoint an additional individual or institution as a separate or Co-Trustee. The following provisions of this Section are adapted to these ends.

The Trustee may appoint an additional individual or institution as a separate or Co-Trustee, in which event each and every remedy, power, right, claim, demand, cause of action,



immunity, estate, title, interest and lien expressed or intended by this Indenture or be exercised by or vested in or conveyed to the Trustee with respect thereto shall be exercisable by and vest in such separate or Co-Trustee, but only to the extent necessary to enable such separate or Co-Trustee to exercise such powers, rights and remedies, and every covenant and obligation necessary to the exercise thereof by such separate or Co-Trustee shall run to and be enforceable by either of them.

Should any deed, conveyance or instrument in writing from the Authority be required by the separate or Co-Trustee so appointed by the Trustee for more fully and certainly vesting in and confirming to him or it such properties, rights, powers, trusts, duties and obligations, any and all such deeds, conveyances and instruments in writing shall, on request, be executed, acknowledged and delivered by the Authority. In case any separate or Co-Trustee, or a successor to either, shall die, become incapable of acting, resign or be removed, all the estates, properties, rights, powers, trusts, duties and obligations of such separate or Co-Trustee, so far as permitted by law, shall vest in and be exercised by the Trustee until the appointment of a new Trustee or successor to such separate or Co-Trustee.

(2)

No. 92-854

Supreme Court U.S.  
FILED  
DEC 16  
1992

**In the Supreme Court of the United States**

OCTOBER TERM, 1992

CENTRAL BANK OF DENVER, N.A.

Petitioner,

v.

FIRST INTERSTATE BANK OF DENVER, N.A., AND  
JACK K. NABER,

Respondents

**ON PETITION FOR A WRIT OF CERTIORARI  
TO THE UNITED STATES COURT OF APPEALS  
FOR THE TENTH CIRCUIT**

**BRIEF FOR RESPONDENTS IN OPPOSITION**

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December 16, 1992

BEST AVAILABLE COPY

## QUESTIONS PRESENTED

1. Whether, by virtue of compliance with the terms of a trust indenture, a trustee who aids and abets a scheme to defraud is exempted from accountability under the federal securities laws?
2. Whether, under the Securities Exchange Act of 1934, recklessness may satisfy the scienter requirement for aiding and abetting where the defendant actively assists the primary wrongdoing?



**RULE 29.1 LIST**

**A. PARENT COMPANIES**

First Interstate Bank of Denver, N.A. is wholly owned by First Interstate Bancorp of Colorado, which is wholly owned by First Interstate Bancorp of Los Angeles.

**B. SUBSIDIARIES (EXCEPT WHOLLY OWNED SUBSIDIARIES)**

First Interstate Bank of Denver, N.A., owns 75 percent of the shares of PMP, Inc.

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# In the Supreme Court of the United States

OCTOBER TERM, 1992

CENTRAL BANK OF DENVER, N.A.

Petitioner,

v.

FIRST INTERSTATE BANK OF DENVER, N.A., AND

JACK K. NABER,

Respondents

## ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

### BRIEF FOR RESPONDENTS IN OPPOSITION

First Interstate Bank of Denver, N.A., ("First Interstate") and Jack K. Naber<sup>1</sup> respectfully oppose the request of Central Bank of Denver, N.A., ("Central Bank" or "Central") that this Court issue a writ of certiorari to review part of the unanimous decision of the United States Court of Appeals for the Tenth Circuit entered on July 8, 1992, and reported as *First Interstate Bank of Denver, N.A., v. Pring*, 969 F.2d 891 (10th Cir. 1992).

### STATEMENT OF THE CASE

Central Bank acted as indenture trustee in an \$11 million bond issue offered by the developer of the Stetson Hills project in Colorado Springs. In June 1988, First Interstate purchased \$2.1 million of the Stetson bonds and resold some of them to its customers. First Interstate had also invested in the developer's earlier offering in 1986, a \$15 million issue. A central covenant of both bond offerings was a so-called "160% test," the unqualified, and highly marketable, promise of the Stetson Hills

<sup>1</sup> Mr. Naber, a customer of First Interstate, was initially proposed as a class action representative. When the federal district court declined to certify a class, Mr. Naber continued in the action as an individual plaintiff.

developer that the bonds would continuously be secured by property worth at least 160% of the outstanding bond principal, and that if the value of the collateral were to fall below 160% the developer would add more property to the lien. These assurances proved fraudulently false.

In early April 1989, only ten months after the 1988 Stetson issue was sold, Central Bank sent letters to all Stetson bondholders, announcing that both issues were in default. The lead underwriter for the 1988 bonds then revealed for the first time that far from satisfying the 160% test, the bond collateral was worth substantially less than the bond principal. The facts developed through informal and formal discovery in the litigation showed that the 1988 bonds had been issued and marketed by means of a fraudulent scheme of the developer, aided by Central Bank, calculated to assure that fatal deficiencies of the bond collateral would be kept hidden from investors until well after the bonds were sold. Central Bank's role in that scheme was pivotal.

As trustee of the 1988 Stetson bonds, Central was obligated under the bond covenants to obtain an appraisal report on the proposed collateral, reflecting compliance with the 160% test. Central was also required to select an appraiser. In early January 1988, an appraisal prepared by Joseph Hastings was presented to Central. The Bank trust officer who reviewed the appraisal noticed that the property valuations which Hastings had arrived at were purportedly no different from the valuations determined by him in 1986, despite an intervening history of declining real estate values in Colorado Springs. Shortly thereafter, the same Central Bank trust officer received a letter from Dain Bosworth, Inc., the lead underwriter of the 1986 Stetson bonds, warning that the critical 160% test was "probably not being met" as to the collateral for the 1986 bonds, and that the Hastings appraisal was "suspect and should not be relied on without further independent check."<sup>2</sup>

The Central Bank trust officer then had Central's own in-house expert review the appraisal for the 1988 bonds. On March 22, 1988, Central wrote a letter to the Stetson developer, summarizing obviously serious deficiencies in Hastings's appraisal and demanding that an independent

<sup>2</sup> In the trial court, First Interstate identified as one of its experts an experienced appraiser of real estate development properties, Mr. James Burbach. Mr. Burbach had appraised the collateral for the 1988 bonds as of the same date used in the Hastings appraisal, and had employed the correct methodology, required by the bond covenants. Burbach's work showed that the Hastings appraisal was inflated by approximately 400 percent.



review be conducted by a different appraiser. In the letter, Central Bank said:

... Based upon our review, and the recommendation given us by [in-house appraiser] Mr. Elmer, we will require, in our capacity as Trustee, that an independent review of the appraisal be conducted by a different appraiser...

We are requiring that an independent review of the appraisal be conducted for the following reasons:

1. The age of the comparable sales data makes it of questionable use as a valid basis for valuation. We question why more recent sales were not utilized for this purpose.
2. Mr. Hastings has confirmed that his discounting methods did not consider a bulk sale and a forced liquidation context, as is specifically required by the Indenture.
3. Based on our review and investigation, the values determined by the appraisal appear to be unjustifiably optimistic, given the current economic conditions in the residential and commercial real estate markets in El Paso County.

(Emphasis added).

Only nine days after Central's trust officer "required" an independent review, her superior, a Bank vice-president, took over responsibility for the transaction. Central then met with the Stetson Hills developer and entered into a concealed side-agreement by which any review of Hastings's "unjustifiably optimistic" appraisal would be postponed until December 1988. The bonds were to be sold to the public in June 1988. The factual circumstances in this case, where a trust officer initially decided to require an independent review, but then a Bank vice-president made a deal with the developer to put off the review until after the bonds were marketed, were unprecedented at Central Bank.

In June 1988, First Interstate and other investors bought the 1988 Stetson bonds ignorant of Central's agreement with the developer and of the multiple deficiencies described in Central's March 22 letter. Only six months later, when an independent appraiser finally evaluated the collateral for the 1988 bonds, the risks concealed by Central Bank's side agreement with the developer materialized, along with substantial losses to First Interstate and to hundreds of other Stetson bondholders.

First Interstate's Complaint alleged that Central Bank should be held accountable as an aider and a bettor under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78a et seq. (1988), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1989).

In the federal district court, First Interstate argued that even under a test of conscious intention to defraud, the facts before the court reflected conduct for which Central Bank's liability could not be precluded by summary judgment. The Tenth Circuit's opinion reviewed the factual background in detail. The court unanimously held that in the face of evidence that Central Bank actively assisted a scheme to delay review of the criticized Hastings appraisal, recklessness would satisfy the scienter requirement. 969 F.2d at 902-04. The court left open the issue of Central Bank's actual knowledge of the fraud, which would supply an alternative ground for a finding of the necessary "scienter." 969 F.2d at 904 n.19.

Central Bank filed a petition for rehearing, making arguments essentially identical to those contained in its Petition in this Court. On August 18, 1992, the petition for rehearing was denied, without dissent.

## ARGUMENT

### I. **THE TRUST INDENTURE ACT EXPRESSLY PRESERVES AN INDENTURE TRUSTEE'S LIABILITY UNDER THE FEDERAL SECURITIES LAWS; CENTRAL BANK SHOWS NO PERSUASIVE LEGAL REASON WHY PERFORMANCE OF ITS CONTRACT WITH A WRONGDOING ISSUER SHOULD PROVIDE IMMUNITY FOR FRAUD**

Section 326 of the Trust Indenture Act of 1939 (the "Indenture Act" or the "Act") states that "[e]xcept as otherwise expressly provided, nothing in this title shall affect . . . the rights, obligations, duties or liabilities of any person under [the Securities Act of 1933, or the Securities Exchange Act of 1934 or the Public Utility Holding Company Act of 1935]." 15 U.S.C. § 77zzz (1988). Citing this provision, the Tenth Circuit held that Central Bank may be liable for aiding and abetting a securities fraud even if it performed all of its contractual duties under the trust indenture. *First Interstate Bank v. Pring*, 969 F.2d 891, 901 (10th Cir. 1992). Central Bank seeks review of this part of the Tenth Circuit's decision, contending that if it performed its duties under the indenture, it should, because of that contractual compliance, be beyond the reach of the anti-fraud provisions of the federal securities laws. (Petition, pp. 6-9). This position is contradicted by the Indenture Act and by existing case law. For the

reasons stated below, respondent First Interstate submits that the Tenth Circuit was correct.

First, the operative statute is clear and unambiguous. The plaintiffs sued the indenture trustee as an aider and abettor of a securities fraud. Under section 326 of the Indenture Act, an indenture trustee is not immune from federal securities liability unless the Act specifically so provides. In this case, the Act provides for no such exemption.

Second, Central Bank fails even to mention the operative section of the Act under which the Tenth Circuit decided the issue. By not explaining how the Tenth Circuit may be said to have incorrectly construed section 326 of the Act, Central Bank offers no meaningful basis for review.

Third, Central Bank has already conceded in its own brief to the Tenth Circuit that, "Plaintiffs correctly point out that the Act does not affect 'the rights, obligations, duties and liabilities of any person' under the federal securities laws." Answer Brief of Defendant-Appellee Central Bank at 29 (quoting 15 U.S.C. § 77zzz). Having taken this position (on which the Tenth Circuit expressly relied, see 969 F.2d at 901), Central Bank may not now persuasively argue a contrary position. See *Hormel v. Helvering*, 312 U.S. 552, 556-57 (1941).

Fourth, Central Bank misapplies section 315 of the Act, under which the indenture is deemed to include a provision that "the indenture trustee shall not be liable except for the performance of such duties as are specifically set out in such indenture." 15 U.S.C. § 77ooo(a)(1) (1988). This provision limits the indenture trustee's affirmative duties arising from the indenture. It cannot reasonably be construed to immunize the indenture trustee from liability for actively assisting the fraudulent securities scheme at issue in this case. Congress emphasized this distinction by enacting section 326, which states that the Act does not affect liability under the federal securities laws.<sup>3</sup>

Fifth, existing law squarely supports the Tenth Circuit's decision. See *Cronin v. Midwestern Okla. Dev. Auth.*, 619 F.2d 856, 861-62 (10th Cir. 1980); *Lewis v. Marine Midland Grace Trust Co. of New York*, 63 F.R.D.

<sup>3</sup> Even if section 326 and section 315 may be said somehow to "conflict" with each other, fundamental rules of statutory construction require the same result. Section 326 of the Act, which specifically states that the Act does not alter liability under the federal securities laws, prevails over the less specific provision in section 315 that an indenture trustee shall only be liable for performance of duties specifically set forth in the indenture. *D. Ginsberg & Sons, Inc. v. Popkin*, 285 U.S. 204, 208 (1932) ("Specific terms prevail over the general in the same or another statute which otherwise might be controlling.").

39, 45-46 (S.D.N.Y. 1973); *Ross v. Bank South N.A.*, 837 F.2d 980, 1003 (11th Cir. 1988). Central Bank cites no persuasive authority to support its theory of contractual immunity from liability under the securities statutes.

Central Bank relies heavily on the Second Circuit's opinion in *Elliot Assoc. v. J. Henry Schroder Bank & Trust Co.*, 838 F.2d 66, 71 (2d Cir. 1988).<sup>4</sup> (Petition at 6). In *Elliot*, the Second Circuit never addressed section 326 of the Indenture Act because the debenture holders failed to allege a violation of the Securities Act of 1933, 15 U.S.C. § 77a *et seq.* (1988), or the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (1988). Rather, the debenture holders in *Elliot* asserted "that the trustee was under a duty—implied from the indenture, the [Indenture] Act or state law—" to act beyond the express terms of the indenture. *Id.* at 70. These facts, materially different from those which confronted the Tenth Circuit in this case, place the claims in *Elliot* well outside the scope of section 326.

## II. STRAINING TO DISCERN A "CONFLICT," CENTRAL BANK MISCHARACTERIZES THE TENTH CIRCUIT AS FOLLOWING A RULE THAT RECKLESSNESS IS THE UNIFORM STANDARD FOR SCIENTER; IN FACT THE TENTH CIRCUIT MUCH MORE NARROWLY HOLDS, CONSISTENT WITH WELL-REASONED PRECEDENT, THAT RECKLESSNESS MAY SATISFY THE SCIENTER REQUIREMENT WHERE THE AIDER AND ABETTOR ACTIVELY ASSISTS THE FRAUD

The Tenth Circuit held that either knowing or reckless conduct may provide the basis for liability where the aider and abettor takes affirmative action which assists the primary wrongdoing.<sup>5</sup> 969 F.2d at 902-03. Specifically, after discussing relevant authority, the Court said:

The cases discussed above reject the idea that the scienter element for aiding and abetting liability cannot be satisfied by recklessness without a duty to disclose. We also reject that view. We hold that in an aiding and abetting case based on

<sup>4</sup> Central also purports to rely upon *Lorenz v. CSX Corp.*, 736 F. Supp. 650, 658 (W.D. Pa. 1990), but there the federal district court did not address section 326 of the Act. (Petition at 6-7).

<sup>5</sup> Based on this finding, the Tenth Circuit did not reach plaintiffs' alternative argument that a material factual issue also exists concerning Central Bank's actual knowledge of the primary violation. 969 F.2d at 904 n.19. Central does not dispute that upon remand, this alternative ground of its liability would, in any event, remain to be decided.



assistance by action, the scienter element is satisfied by recklessness.

969F.2d at 903 (emphasis supplied). First Interstate submits that under the particular facts of this case the Tenth Circuit was correct, and that its decision represents no conflict with prior precedent.

In cases where liability is premised on silence or inaction, the federal courts have generally agreed that recklessness will not establish scienter unless the aider or abettor has a "duty to disclose" the primary violation. See, e.g., *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 97 (5th Cir. 1975). Central Bank argues that the same rule should be extended to cases like this one, where the aider and abettor actively assists the primary violation. However, the factual settings and the holdings of many of the purported "majority" cases that Central Bank cites do not support its contention. See *IIT v. Cornfeld*, 619 F.2d 909, 922-25 (2d Cir. 1980) (involving "mere inaction" by aider and abettor); *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 776-78 (1st Cir. 1983) ("The inaction and silence of the defendants is the sole basis on which the plaintiffs attempt to ground the defendants' aiding and abetting liability."); *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1127 (5th Cir. 1988) ("[Fifth Circuit precedent] establishes a single test for scienter that varies as the level of assistance decreases on a sliding scale from recklessness to 'conscious intent.'"), *cert. denied*, 492 U.S. 918 (1989), and *vacated on other grounds sub nom. Fryar v. Abell*, 492 U.S. 914 (1989); *Woods v. Barnett Bank of Fort Lauderdale*, 765 F.2d 1004, 1010 (11th Cir. 1985) (following Fifth Circuit's "sliding scale" test). The holdings of these cases, as opposed to Central Bank's characterization of them, do not conflict with what Central strives to recast as a "minority" rule of the D.C., Eighth,<sup>6</sup> Ninth, and now, Tenth Circuits that in some circumstances affirmative aiding and abetting may be actionable if accompanied by a reckless state of mind.

Central Bank also mischaracterizes the Ninth and Tenth Circuits as "effectively establish[ing] recklessness as the universal standard for scienter." (Petition at 12). In the Ninth Circuit case where Central says that

<sup>6</sup> The Eighth Circuit has followed the Fifth Circuit's "sliding scale" test. See *FDIC v. First Interstate Bank of Des Moines, N.A.*, 885 F.2d 423, 430 (8th Cir. 1989) (Under the Fifth Circuit rule, "the intent requirement becomes greater as the activity in question is more remote"). If there had been doubt about the Fifth Circuit's position, it was very recently clarified by *Akin v. Q-L Investments Inc.*, 959 F.2d 521 (5th Cir. 1992), which states that "an accountant may be held liable for recklessly aiding and abetting a primary violation . . . when his assistance in the fraud is particularly substantial and unusual or when he owes some special duty of disclosure." *Id.* at 526 (emphasis added).

the federal appellate court "drops the pretense of the duty to disclose requirement altogether" (Petition at 13), the Ninth Circuit in fact quite carefully limited its ruling to a situation involving active assistance. *Levine v. Diamanthuset, Inc.*, 950 F.2d 1478, 1484 n.4, 1485 n.5 (9th Cir. 1991). Concerning an alleged active aider and abettor, the Ninth Circuit. stated:

[W]e do not discuss the [aider and abettor's duty to disclose] because [its] aiding and abetting liability is premised in part not on silence, but on actual misrepresentations. . . . [I]t may be necessary to revisit the question of [the aider and abettor]'s duty to disclose if aiding and abetting liability is ultimately to be premised only on the appearance of [the aider and abettor]'s name in [the issuer]'s promotional materials.

*Id.* at 1485 n.4.

The Tenth Circuit could also have reversed based on Central Bank's actual knowledge, an issue which remains for disposition in the trial court. On the facts of this case, the Tenth Circuit's decision was correct.

## CONCLUSION

Central Bank's Petition fails to address the controlling law properly relied upon by the Tenth Circuit and mischaracterizes the Tenth Circuit's opinion in order to suggest a reviewable conflict with other circuits. Petitioner has shown no fundamental respect in which the decision of the United States Court of Appeals or the method of decision of that Court, either requires reversal or merits review. The Petition should be denied.



Respectfully submitted this 16th day of December 1992.

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(3)  
**No. 92-854**

Supreme Court, U.S.

**FILED**

**DEC 31 1992**

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**IN THE**  
**Supreme Court of the United States**  
**OCTOBER TERM, 1992**

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*v.*

*Petitioner,*

**FIRST INTERSTATE BANK OF DENVER, N.A. and**  
**JACK K. NABER,**

*Respondents.*

**On Petition For Writ Of Certiorari**  
**To The United States Court Of Appeals**  
**For The Tenth Circuit**

**PETITIONER'S REPLY MEMORANDUM IN SUPPORT OF**  
**PETITION FOR WRIT OF CERTIORARI**

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**No. 92-854**

IN THE

**Supreme Court of the United States**

OCTOBER TERM, 1992

CENTRAL BANK OF DENVER, N.A.,

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*Petitioner,*

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*Respondents.*

On Petition For Writ Of Certiorari  
To The United States Court Of Appeals  
For The Tenth Circuit

PETITIONER'S REPLY MEMORANDUM IN SUPPORT OF  
PETITION FOR WRIT OF CERTIORARI

Under the reasoning of Respondents and the Tenth Circuit, Petitioner Central Bank of Denver, N.A. ("Central Bank") can be held liable for aiding and abetting a securities fraud without any finding that it violated its duties as indenture trustee or possessed any fraudulent intent or knowledge of a scheme to defraud. There is simply no support for such a result. Moreover, Respondents cannot conceal the conflict between the Tenth Circuit's holding and that of a majority of the federal circuits that recklessness does not satisfy the scienter requirement for aiding and abetting absent a duty to disclose.

# I. CENTRAL BANK WAS NOT RECKLESS WHERE IT MET ITS DUTIES UNDER THE TRUST INDENTURE.

For the reason discussed in Section II of Central Bank's Opening Brief, Central Bank should not be held liable for aiding and abetting a Rule 10b-5 violation based merely on recklessness. However, even if recklessness were sufficient to meet the requirement of scienter, Central Bank could not have been reckless where, as the Tenth Circuit found, it met its duties under the trust indenture. The Tenth Circuit's holding that an indenture trustee may be liable without violating any of its indenture duties directly conflicts with the Trust Indenture Act, which expressly limits the trustee's duties to those set out in the indenture. 15 U.S.C. § 77000 (1988).

Respondents argue that the Trust Indenture Act does not grant trustees immunity for securities fraud. That argument entirely misses the point. Central Bank is not liable because Central Bank met all its duties; therefore, it could not have been reckless. In the securities context, "recklessness" is defined as "an extreme departure from the standards of ordinary care, and which presents a danger . . . that is either known to the defendant or is so obvious that the actor must have been aware of it." *First Interstate Bank v. Pring*, 969 F.2d 891, 903 (10th Cir. 1992) (quoting *Hackbart v. Holmes*, 675 F.2d 1114, 1118 (10th Cir. 1982)). The Tenth Circuit acknowledged that under the Trust Indenture Act a trustee's duties are limited to the terms of the indenture. It then found that Central Bank did not breach any of its indenture duties. Thus, the Tenth Circuit's decision that Central Bank may have been reckless without violating any of its duties as trustee is a logical impossibility.

Central Bank does not claim that the Trust Indenture Act establishes immunity. Liability can surely be based upon conscious intent to defraud even in the absence of a breach of duty, a question the Tenth Circuit has not addressed at this

point. That, however, is not at issue.<sup>1</sup> Respondents' reliance on § 326 of the Trust Indenture Act, 15 U.S.C. § 77zzz (1988), does not explain how Central Bank could have entirely met its duties yet committed an extreme departure from ordinary care. Section 326 merely preserves liability against a trustee who meets his indenture duties but knowingly and consciously participates in a fraud.<sup>2</sup> It cannot be read to create liability for recklessness when the trustee has met all of his duties as defined under § 315.<sup>3</sup>

Respondents' attempt to distinguish *Elliott Assoc. v. J. Henry Schroder Bank & Trust Co.*, 838 F.2d 66 (2d Cir. 1988), and *Lorenz v. CSX Corp.*, 736 F. Supp. 650 (W.D. Pa. 1990),

<sup>1</sup> If, on remand, liability can only be imposed on Central Bank upon a finding of actual knowledge or conscious intent, Central Bank must necessarily prevail because Respondents have offered no evidence of either.

<sup>2</sup> The cases cited by Respondents hold no more. See *Cronin v. Midwestern Oklahoma Dev. Authority*, 619 F.2d 856, 862 (10th Cir. 1980) (trustee liability possible if facts reveal that it "knowingly aided the underwriter in the issuance of value-depleted bonds"); *Lewis v. Marine Midland Grace Trust Co.*, 63 F.R.D. 39, 46 (S.D.N.Y. 1973) ("If the elements alleged in the complaint are substantiated, there can be little doubt of the culpability of all of the defendants as knowing participants in a fraudulent scheme."). *Ross v. Bank South, N.A.*, 837 F.2d 980 (11th Cir. 1988), cited by Respondents, actually supports Central Bank's position. There the court affirmed summary judgment in favor of the indenture trustee based on the lack of "proof that Bank South failed in any way in its duty as indenture trustee." *Id.* at 1003 (emphasis added).

<sup>3</sup> Respondents demonstrate their confusion by quoting from Central Bank's own brief to the court below. That passage, taken in context, reads:

While Plaintiffs correctly point out that the Act does not affect "the rights, obligations, duties and liabilities of any person" under the federal securities laws, the burden remains on the Plaintiffs to state a claim under those laws. There can be no claim where there is no breach of duty.

Answer Brief of Defendant-Appellee Central Bank at 29 (emphasis added). Central Bank has never conceded the illogical proposition that recklessness can be established absent a breach of the trustee's duties.



merely because those opinions do not explicitly discuss § 326 is ineffectual. Both courts squarely held that a trustee's duties are defined by the terms of the indenture. The Tenth Circuit's finding that Central Bank may have been reckless while complying with all terms of the Indenture conflicts with these opinions and, more importantly, with § 315 of the Trust Indenture Act of 1939. 15 U.S.C. § 77000 (1988).

## II. RESPONDENTS CANNOT AVOID THE CONFLICT BETWEEN THE DECISION BELOW AND A MAJORITY OF THE FEDERAL CIRCUITS.

The Tenth Circuit's decision that recklessness satisfies the scienter requirement for aiding and abetting a securities fraud even when there is no duty to disclose conflicts with the holdings of every circuit which has addressed the issue except the Ninth. Respondents attempt to reconcile the Tenth Circuit's holding with the majority rule by arguing that recklessness is sufficient if there is assistance by action. Upon examination of the facts of the relevant cases, however, Respondents' reconciliation crumbles.

First, in this case the Tenth Circuit characterized Respondents' claim as stemming from Central Bank's "affirmative action" of "agreeing to delay the independent review of the Hastings appraisal." 969 F.2d at 902 (emphasis in original). The Respondents themselves characterize Central Bank's conduct more accurately in their Complaint as inaction, that is, Central Bank's failure to insist upon a prompt independent review of the Hastings appraisal.

Second, the cases cited by Respondents may just as easily be considered instances of "affirmative actions" under the Tenth Circuit's loose standard. See, e.g., *Ross v. Bolton*, 904 F.2d 819, 822-824 (2d Cir. 1990) (defendant allegedly acted as clearing agent for primary violator, financed primary violator's \$1.25 million securities purchase, conducted a telephone conversation with plaintiff and dominated and controlled the primary violator); *IIT v. Cornfeld*, 619 F.2d

909, 915 (2d Cir. 1980) (defendant accountant audited and certified allegedly inaccurate financial statements); *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1124-1126 (recklessness insufficient where attorney substantially assisted underwriters' scheme by providing legal advice, allegedly preparing offering statement and allowing name to be used on statement), *cert. denied*, 492 U.S. 918 (1989), and *vacated on other grounds sub nom. Fryar v. Abell*, 432 U.S. 914 (1989); *Camp v. Dema*, 948 F.2d 455, 462 (8th Cir. 1991) (recklessness insufficient where director voted to authorize negotiations to sell company, agreed to sell stock, and waived preemptive rights in the course of allegedly fraudulent transaction). In each of these "inaction" cases, as will virtually always be true, the defendants, like Central Bank, took some affirmative action which under the Tenth Circuit's approach would have permitted a recklessness standard to be applied. Yet in none of these cases did the court find recklessness an adequate standard. Thus, Respondents cannot avoid the conflict between these cases and the Tenth Circuit's decision.

With the Ninth, and now Tenth, Circuits both applying insubstantial, unnecessary distinctions in cases involving a crucial area of national commerce, there is a paramount need for review of this issue.



**CONCLUSION**

For the foregoing reasons, and the reasons stated in the petition, certiorari should be granted.

Respectfully submitted this 31st day of December, 1992.

TUCKER K. TRAUTMAN

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NEAL S. COHEN

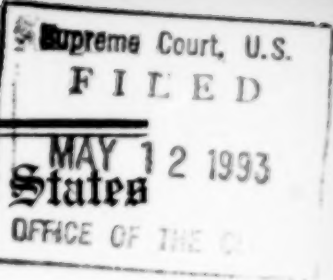
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**In the Supreme Court of the United States**

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ON PETITION FOR A WRIT OF CERTIORARI TO THE  
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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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## QUESTIONS PRESENTED

1. Whether an indenture trustee for a municipal bond offering may be held liable for recklessly aiding and abetting violations of antifraud provisions of the Securities Exchange Act of 1934 in connection with the offering even though the trustee had no duty of disclosure under the trust indenture.

2. Whether recklessness, in contrast to actual knowledge, is sufficient to satisfy the scienter element of aiding-and-abetting liability under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), where the defendant's substantial assistance of the primary wrongdoing consisted of affirmative action rather than pure inaction or silence.



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# In the Supreme Court of the United States

OCTOBER TERM, 1992

No. 92-854

CENTRAL BANK OF DENVER, N.A., PETITIONER

v.

FIRST INTERSTATE BANK OF DENVER, N.A.,  
AND JACK K. NABER

ON PETITION FOR A WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS  
FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is filed in response to the Court's invitation to the Solicitor General to express the views of the United States.

## STATEMENT

1. In two separate offerings in 1986 and 1988, the Colorado Springs-Stetson Hills Public Building Authority (the Authority) sold bonds to finance public improvements built by the developer of a planned community in Colorado Springs, Colorado. The bonds were secured by land that was required to have an appraised value of at least 160% of the outstanding principal and interest (the 160% test). Petitioner served as the indenture trustee for both offerings.<sup>1</sup> Pet. App. A4-A5.

<sup>1</sup> Petitioner's role and duties as trustee for the bonds are set forth in the trust indentures for the 1986 and 1988 bonds. See Pet. App. A41-A50 (excerpts of 1988 indenture).



In early 1988, before the 1988 bond offering had commenced, petitioner received an appraisal from the same appraiser who had appraised the property securing the 1986 bonds. The 1988 appraisal updated the original 1986 appraisal of the land securing the 1986 bonds and, in addition, valued the separate parcels that were to secure the 1988 bonds. The 1988 appraisal showed land values essentially unchanged from the earlier 1986 appraisal. Pet. App. A5-A6. Petitioner knew that real estate values had declined in the Colorado Springs area in that two-year period. *Id.* at A7 n.6.

Thereafter, petitioner received two letters from the underwriter for the 1986 offering. Those letters stated that the 160% test for the 1986 offering was not being met and expressed concern that the original appraisal for the 1986 bonds was outdated, that the 1988 appraisal was using inflated real estate values, and that the Authority may have given "false and misleading certifications" of compliance with the 1986 bond covenants. Pet. App. A6. Petitioner's investigation of the 1988 appraisal raised similar questions concerning the accuracy of the appraisal and the sufficiency of the collateral. Accordingly, as trustee for the 1986 bonds, petitioner directed "that an independent review of the appraisal be conducted by a different appraiser." *Id.* at A7.

Petitioner then held a series of meetings concerning the appraisal with representatives of the Authority, the developer, and others. As a result of those meetings, petitioner dropped its demand for an immediate review of the appraisal. Instead, petitioner agreed to defer the review until December 1, 1988—six months after the 1988 bonds were to be sold—in exchange for the developer's agreement to pledge an additional \$2 million in property as security for the 1986 bonds. Pet. App. A8 & n.7. No additional property was pledged as security for the 1988 bonds. *Id.* at A27.

The 1988 bonds were sold in June 1988. Pet. App. A4. In December 1988, the independent appraisal of the

collateral was begun, but the Authority refused to complete that appraisal. Instead, the Authority defaulted on its payment obligations for the 1988 bonds. *Id.* at A9.

2. Respondents, purchasers of some of the 1988 bonds, brought this action in the United States District Court for the District of Colorado against petitioner and others connected with the offering, alleging that the 1988 bonds were sold as part of a fraudulent scheme in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5. Respondents alleged that the bonds were marketed through a fraudulently false and misleading disclosure document that represented the 1988 appraisal as being correct but that failed to disclose the doubts raised about the accuracy of that appraisal and the sufficiency of the collateral. Respondents further alleged that petitioner, with actual knowledge or recklessness, aided and abetted the fraudulent scheme by withdrawing its demand for an immediate independent review of the appraisal and by agreeing to delay the review until after the 1988 bonds had been sold. Pet. App. A4, A9, A20, A27 & n.19.

The district court granted summary judgment for petitioner. Pet. App. A29-A36. The court held that the scienter requirement for aiding-and-abetting liability "may not be satisfied by showing recklessness absent an additional duty to disclose." *Id.* at A33. Since respondents had failed to raise a genuine issue of material fact as to petitioner's actual knowledge or the existence of a duty to disclose, the court rejected respondents' aiding-and-abetting claim.

3. The court of appeals reversed and remanded. Pet. App. A3-A28. The court began its analysis by agreeing with the district court that petitioner owed respondents no duty to disclose. The court explained that, under the Trust Indenture Act of 1939, 15 U.S.C. 77aaa *et seq.*, petitioner's duties as bond indenture trustee were "strictly defined and limited to the terms of the indenture." Pet.

App. A20 (citing *Elliott Assocs. v. J. Henry Schroder Bank & Trust Co.*, 838 F.2d 66, 71 (2d Cir. 1988); 15 U.S.C. 7700o(a)(1)). The court held, however, that "the lack of a duty to disclose is not dispositive in this case," because the Trust Indenture Act leaves undisturbed whatever "rights, obligations, duties [, or] liabilities" are imposed by the federal securities laws. Pet. App. A20 (citing 15 U.S.C. 77zzz). Accordingly, the court concluded that petitioner could be liable for aiding and abetting notwithstanding the absence of any duty to disclose. Pet. App. A20-A21.

Turning to the question of petitioner's liability as an aider and abettor, the court observed that "[s]everal courts expressly have held that recklessness satisfies the scienter requirement for aiding-and-abetting liability" (Pet. App. A21), while other courts "have indicated that recklessness is not sufficient scienter for aiding-and-abetting liability unless the defendant had a fiduciary duty." *Id.* at A22. Adopting the former view, the court of appeals held that, where a defendant affirmatively takes action to assist a primary violation of the securities laws, an allegation of recklessness is sufficient to satisfy the scienter requirement for aiding-and-abetting liability even absent a duty to disclose. *Id.* at A23-A25 (citing *Levine v. Diamantheset, Inc.*, 950 F.2d 1478, 1484-1485 & nn. 4-5 (9th Cir. 1991); and *FDIC v. First Interstate Bank*, 885 F.2d 423, 432-433 (8th Cir. 1989)).

The court of appeals also concluded that this case involves allegations of affirmative action, not mere silence or inaction, because petitioner "affirmatively agree[d] to delay the independent review of the [1988] appraisal." Pet. App. A23. Accordingly, the court held that recklessness was the appropriate standard of scienter in the circumstances of this case, and turned to an examination of the record to determine whether the trier of fact could reasonably conclude that petitioner's conduct was reckless. *Id.* at A25-A26.

Considering the evidence in the light most favorable to plaintiffs, the court found that petitioner's decision to delay the independent review of the 1988 appraisal was highly unusual, and that "this was not an ordinary transaction." Pet. App. A26. Moreover, petitioner had agreed to delay the independent review despite its concerns about the accuracy of the appraisal and its knowledge of the upcoming sale of the 1988 bonds. Under those circumstances, the court concluded that the record would support a finding of recklessness. *Id.* at A27.<sup>2</sup>

### DISCUSSION

The court of appeals held that an indenture trustee can be subjected to liability for aiding and abetting a violation of the securities laws in the absence of a breach of the trustee's duties as set forth in the trust indenture. Petitioner's challenge to that ruling does not present a significant legal issue warranting this Court's review.

The court of appeals also held that recklessness satisfies the scienter requirement for aiding-and-abetting liability under Section 10(b) and Rule 10b-5 in cases in which the defendant's affirmative action substantially assists the primary violation, even if the defendant does not owe a duty of disclosure to the plaintiff.<sup>3</sup> Although we believe that the court's decision was correct, we agree with petitioner that this issue warrants review. In our view, the courts of appeals have adopted materially different tests for determining when recklessness satisfies the scienter element of aiding-and-abetting liability. Because the passage of time does not appear to be lessening the

<sup>2</sup> The court of appeals also concluded that the evidence would support a finding that, by agreeing to delay the independent review of the 1988 appraisal, petitioner provided "substantial assistance" to the fraudulent scheme. Pet. App. A28.

<sup>3</sup> As noted above, the court of appeals held that petitioner owed no duty of disclosure to respondents. Pet. App. A20. Respondents do not appear to dispute that holding.



disagreement among the circuits in this regard, review by this Court is necessary to resolve the conflict.

1. Petitioner contends (Pet. 5-10; Pet. Reply Br. 2-4) that, as a matter of law, a bond indenture trustee cannot be deemed to have acted recklessly so long as it has satisfied its obligations under the trust indenture. According to petitioner (Pet. 4, 7), the court of appeals' decision to the contrary "eviscerates the protections for indenture trustees" under, and "directly conflicts" with, the Trust Indenture Act of 1939 (TIA), 15 U.S.C. 77aaa *et seq.*

The question framed by petitioner does not arise on the facts of this case. Petitioner states (Pet. 2) that the bonds involved in this case are municipal bonds. As a result, the TIA appears to have no applicability here. Pursuant to Section 304(a)(4)(B) of the TIA, "[t]he provisions of [the TIA] shall not apply to \* \* \* any security exempted from the provisions of the Securities Act of 1933 \* \* \* by paragraph (2) of subsection 3(a) thereof." 15 U.S.C. 77ddd(a)(4)(B).<sup>4</sup> Section 3(a)(2) of the Securities Act of 1933, in turn, exempts all securities (such as municipal bonds) issued by the States and their political subdivisions or instrumentalities. 15 U.S.C. 77c(a)(2).<sup>5</sup>

<sup>4</sup> As the statutory language expressly provides, the exemption provided by Section 304(a) of the TIA is an exemption from the TIA as a whole, not merely an exemption from any one provision of the Act. See *Friedman v. Chesapeake & O. Ry.*, 261 F. Supp. 728, 731 (S.D.N.Y. 1966) (exempt from "the provisions of the [TIA]"), *aff'd*, 395 F.2d 663 (2d Cir. 1968) (*per curiam*), *cert. denied*, 393 U.S. 1016 (1969); *Dau v. Storm Lake Production Credit Ass'n*, 626 F. Supp. 862, 864 (N.D. Iowa 1985); *Dau v. Federal Land Bank*, 627 F. Supp. 346, 348-349 (N.D. Iowa 1985); 4 L. Loss & J. Seligman, *Securities Regulation* 1641 (3d ed. 1990).

<sup>5</sup> The Authority represented in the Official Statement for the 1988 bonds (second unnumbered page) that the bonds were not registered under the Securities Act of 1933, presumably because it concluded that the bonds were exempt from such registration

In any event, even if the 1988 bonds were subject to the TIA, that Act would not immunize petitioner from liability in this case. Petitioner relies on Section 315(a)(1) of the TIA, which permits trust indentures to provide that "the indenture trustee shall not be liable except for the performance of such duties as are specifically set out in [the] indenture." 15 U.S.C. 77ooo(a)(1).<sup>6</sup> Section 326 of the TIA states, however, that "[e]xcept as otherwise expressly provided, nothing in [the TIA] shall affect \* \* \* the rights, obligations, duties, or liabilities of any person under" other federal securities laws, including the Securities Exchange Act of 1934. 15 U.S.C. 77zzz.<sup>7</sup> Petitioner appears to concede (Pet. Reply Br. 2) that the TIA does not establish immunity from claims of securities fraud violations, which form the basis of this suit.

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as municipal bonds issued by a political subdivision of the State. See also Official Statement, first unnumbered page (referring to "the Authority or any *other* political subdivision") (emphasis added).

<sup>6</sup> After the events at issue in this case, Section 315(a) was amended to state that this provision would automatically be deemed included in every trust indenture absent an express statement to the contrary. See Trust Indenture Reform Act of 1990, Pub. L. No. 101-550, Tit. IV, § 414, 104 Stat. 2730.

<sup>7</sup> The "[e]xcept as otherwise expressly provided" clause of Section 326 is not a reference to Section 315. That clause refers instead to provisions like Section 310(c) of the TIA, 15 U.S.C. 77jjj(c), which expressly exempts indenture trustees from any inconsistent requirements that might be imposed by another securities law in certain circumstances. See also TIA § 305(d), 15 U.S.C. 77eee(d) (expressly exempting certain conduct from specified provisions of the Securities Act of 1933). Section 315 contains no such language; indeed, it does not even refer to the provisions of any other securities laws, and thus cannot be deemed to "expressly provide[]" for an exemption from those laws within the meaning of Section 326.



Petitioner asserts (Pet. 6; Pet. Reply Br. 2, 4) that it is a "logical impossibility" for it to have acted recklessly when it "did not breach any of its indenture duties" and therefore was "complying with all terms of the Indenture."<sup>8</sup> What petitioner ignores, however, is that under the Securities Exchange Act it is unlawful for any person to knowingly or recklessly aid and abet a violation of Section 10(b). Thus, wholly independent of petitioner's duties under the trust indenture, and regardless of whether petitioner satisfied those duties, petitioner's conduct is actionable under Section 10(b) to the same extent it would have been in the absence of the trust indenture. See Pet. App. A20-A21, A28.

Petitioner cites no court of appeals decision to the contrary. Petitioner places principal reliance on *Elliott Assocs. v. J. Henry Schroder Bank & Trust Co.*, 838 F.2d 66 (2d Cir. 1988), but that case is wholly inapposite. In *Elliott Assocs.*, the plaintiffs asserted only that the indenture trustee had breached its duties "under the indenture, the [Trust Indenture] Act[,] and state law." 838 F.2d at 67. No claim was asserted under the Securities Exchange Act, and thus the court had no occasion to consider the effect of Section 326 of the TIA, 15 U.S.C. 77zzz, which makes clear that the TIA does not

<sup>8</sup> It is far from clear that petitioner is correct in asserting that it complied with all of its obligations under the trust indenture and the TIA. Section 315(d)(2) of the TIA provides that an indenture trustee is not protected from liability for "any error of judgment made in good faith \* \* \* [where] it shall be proved that such trustee was negligent in ascertaining the pertinent facts." 15 U.S.C. 77000(d)(2). Similarly, while the indenture gave petitioner the discretionary right to require an independent appraisal of the collateral, it required petitioner to exercise that discretion in a non-negligent manner. Pet. App. A44, A45 (Indenture of Trust, Section 9.01(g) and (k)). Thus, the TIA and the trust indenture do not immunize petitioner from liability even for negligence; *a fortiori*, they provide no protection against respondents' allegations of reckless misconduct.

override the obligations and duties imposed by the Securities Exchange Act.<sup>9</sup>

Similarly, petitioner's reliance (Pet. Reply Br. 3 n.2) on *Ross v. Bank South, N.A.*, 837 F.2d 980, 1003, vacated, 848 F.2d 1132 (1988), on reh'g, 885 F.2d 723 (11th Cir. 1989) (en banc), cert. denied, 495 U.S. 905 (1990), is misplaced. That opinion was vacated by the full Eleventh Circuit, and it therefore has no precedential effect. See *County of Los Angeles v. Davis*, 440 U.S. 625, 634 n.6 (1979). Moreover, the vacated panel opinion in *Bank South* did not suggest that an indenture trustee may recklessly aid and abet securities fraud with impunity so long as it complies with its obligations under the trust indenture; rather, the *Bank South* panel pointed to the trustee's compliance with its duties as merely one factor tending to support the conclusion that the trustee had not aided and abetted the fraud. 837 F.2d at 1003. Accordingly, there is no conflict on this question, and the court of appeals' correct ruling would not warrant further review even if the TIA were applicable in this case.

2. a. Petitioner contends (Pet. 10-15) that the court of appeals erred in holding that proof of recklessness is sufficient to satisfy the scienter requirement for aiding-and-abetting liability in cases in which the defendant's affirmative acts assisted a primary violation of the securities laws. In our view, the court of appeals was correct in adopting a recklessness standard in the circumstances of this case.

The precise formulation of the test for aiding-and-abetting liability under Section 10(b) and Rule 10b-5 varies from circuit to circuit.<sup>10</sup> In general, however, a

<sup>9</sup> The district court in *Lorenz v. CSX Corp.*, 736 F. Supp. 650, 658 (W.D. Pa. 1990), also did not discuss or even refer to Section 326, and thus its analysis of the liability of indenture trustees under the securities laws is necessarily flawed.

<sup>10</sup> This Court has left open the question whether a cause of action for aiding-and-abetting liability exists under Section 10(b)

plaintiff must prove three elements in order to impose aiding-and-abetting liability on a defendant: (1) the existence of a primary Section 10(b) violation by another; (2) scienter on the part of the alleged aider and abettor; and (3) substantial assistance by the alleged aider and abettor in achieving the primary violation.<sup>11</sup> This case

and Rule 10b-5. See *Herman & MacLean v. Huddleston*, 459 U.S. 375, 379 n.5 (1983); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 192 n.7 (1976). Every court of appeals to address the question (with the arguable exception of the Seventh Circuit) has held that aiding-and-abetting liability is available under Section 10(b) and Rule 10b-5. See note 11, *infra*. Petitioner does not dispute that proposition, which we believe has been correctly settled by the courts of appeals.

<sup>11</sup> See, e.g., *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983); *IIT, An International Investment Trust v. Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980); *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 799 (3d Cir.), cert. denied, 439 U.S. 930 (1978); *Schatz v. Rosenberg*, 943 F.2d 485, 495 (4th Cir. 1991), cert. denied, 112 S. Ct. 1475 (1992); *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1126 (5th Cir. 1988), vacated in part on other grounds, 492 U.S. 914 (1989), and cert. denied, 492 U.S. 918 (1989); *Herm v. Stafford*, 663 F.2d 669, 684 (6th Cir. 1981); *K & S Partnership v. Continental Bank, N.A.*, 952 F.2d 971, 977 (8th Cir. 1991), cert. denied, 112 S. Ct. 2993 (1992); *Jett v. Sunderman*, 840 F.2d 1487, 1495 (9th Cir. 1988); *Farlow v. Peat, Marwick, Mitchell & Co.*, 956 F.2d 982, 986 (10th Cir. 1992); *Woods v. Barnett Bank*, 765 F.2d 1004, 1009 (11th Cir. 1985).

The Seventh Circuit has adopted a different test for aiding-and-abetting liability. In order for a defendant to be liable for aiding and abetting under that test, he must "(1) commit one of the 'manipulative or deceptive' acts prohibited under section 10(b) and rule 10b-5 (2) with the same degree of scienter that primary liability requires." *Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1123 (7th Cir. 1990), cert. denied, 111 S. Ct. 1317 (1991); see *LHLC Corp. v. Cluett, Peabody & Co.*, 842 F.2d 928, 932 (7th Cir.), cert. denied, 488 U.S. 926 (1988); *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495 (7th Cir. 1986). One commentator has argued that the Seventh Circuit's test "would eliminate aiding and abetting liability because the defendant who met the requirements would be liable as a primary violator." Kuehnle,

concerns only the second element of this test, *i.e.*, the scienter requirement.<sup>12</sup>

In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), this Court left open the question whether recklessness could satisfy the scienter requirement for primary liability under Section 10(b) and Rule 10b-5. 425 U.S. at 194 n.12. All of the courts of appeals that have considered the question in light of *Hochfelder* have held that recklessness is sufficient to establish primary liability,<sup>13</sup> and that recklessness can satisfy the scienter requirement

*Secondary Liability Under the Federal Securities Laws—Aiding and Abetting, Conspiracy, Controlling Person, and Agency: Common-Law Principles and The Statutory Scheme*, 14 J. Corp. L. 313, 320 (1988).

<sup>12</sup> Petitioner apparently did not argue below that the evidence was insufficient to permit a jury to find a primary violation of the securities laws. Petitioner did contend that it did not provide substantial assistance to the fraudulent scheme, and thus that respondents had not satisfied the third element of the test for aiding-and-abetting liability. The court of appeals found (Pet. App. A28), however, that there was a genuine issue of material fact as to that element, and petitioner does not contest that fact-bound ruling in its petition.

<sup>13</sup> See, e.g., *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 46-47 (2d Cir.), cert. denied, 439 U.S. 1039 (1978); *McLean v. Alexander*, 599 F.2d 1190, 1197 (3d Cir. 1979); *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 961-962 (5th Cir.) (en banc), cert. denied, 454 U.S. 965 (1981); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1024 (6th Cir. 1979); *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1044 (7th Cir.), cert. denied, 434 U.S. 875 (1977); *Van Dyke v. Coburn Enterprises, Inc.*, 873 F.2d 1094, 1100 (8th Cir. 1989); *Nelson v. Serwold*, 576 F.2d 1332, 1337 (9th Cir.), cert. denied, 439 U.S. 970 (1978); *Hackbart v. Holmes*, 675 F.2d 1114, 1117 (10th Cir. 1982); *SEC v. Carriba Air, Inc.*, 681 F.2d 1318, 1324 (11th Cir. 1982).

Most courts of appeals, including the Tenth Circuit, follow the Seventh Circuit's *Sundstrand* standard, or some variant thereof, in defining recklessness. See *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569 & n.8 (9th Cir. 1990) (en banc) (citing cases),



for aiding-and-abetting liability in at least some circumstances.<sup>14</sup>

In our view, recklessness should generally satisfy the scienter standard in aiding-and-abetting cases.<sup>15</sup> Where

cert. denied, 111 S. Ct. 1621 (1991). In *Sundstrand*, the court defined a reckless omission as

a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.

553 F.2d at 1047.

<sup>14</sup> See, e.g., *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983); *Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990); *Akin v. Q-L Investments, Inc.*, 959 F.2d 521, 526-527 (5th Cir. 1992); *Herm v. Stafford*, 663 F.2d 669, 684 (6th Cir. 1981); *Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1126 (7th Cir. 1990), cert. denied, 111 S. Ct. 1317 (1991); *Camp v. Dema*, 948 F.2d 455, 459-460 (8th Cir. 1991); *Levine v. Diamanthuset, Inc.*, 950 F.2d 1478, 1484-1485 & nn.4-5 (9th Cir. 1991); *Woods v. Barnett Bank*, 765 F.2d 1004, 1010 (11th Cir. 1985); see also *Dirks v. SEC*, 681 F.2d 824, 844-845 & n.27 (D.C. Cir. 1982) (opinion of Wright, J.) rev'd on other grounds, 463 U.S. 646 (1983).

<sup>15</sup> One possible exception to the general rule that recklessness should suffice to establish scienter in aiding-and-abetting cases involves cases in which the defendant's substantial assistance consists of pure inaction or silence and the defendant has no independent duty to disclose or act. A number of courts have indicated that evidence of conscious intent to aid the fraudulent scheme is or may be required before aiding-and-abetting liability may be imposed in such cases. See, e.g., *Pet. App. A17-A18*; *Schneberger v. Wheeler*, 859 F.2d 1477, 1480 (11th Cir. 1988), cert. denied, 490 U.S. 1091 (1989); *Moore v. Fenex, Inc.*, 809 F.2d 297, 303-304 (6th Cir.), cert. denied, 483 U.S. 1006 (1987); *Metge v. Baehler*, 762 F.2d 621, 625 & n.1 (8th Cir. 1985), cert. denied, 474 U.S. 1057 and 474 U.S. 1072 (1986); *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d at 800; *Woodward v. Metro Bank*, 522 F.2d 84, 97 (5th Cir. 1975). Other courts have suggested that there can be no aiding-and-abetting liability at all in such cases, regardless of the defendant's state of mind. See, e.g., *Schatz v. Rosenberg*, 943 F.2d at 496-497;

primary violations are involved, recklessness has long been recognized as a form of scienter, both in securities fraud cases (see note 13, *supra*) and in common-law fraud cases (see *Restatement (Second) of Torts* § 526(b) comment c (1977); *Prosser and Keeton on the Law of Torts* § 107, at 741-742 (W. Keeton 5th ed. 1984)).<sup>16</sup> Recklessness is properly viewed as a form of knowing or intentional conduct,<sup>17</sup> because one who acts with reckless

*Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495-496 (7th Cir. 1986); *Weasel v. Buhler*, 437 F.2d 279, 283 (9th Cir. 1971); cf. *IIT, An International Investment Trust v. Cornfeld*, 619 F.2d at 925-927. In this case, the court of appeals concluded that the evidence would support a finding that petitioner actively assisted the fraudulent scheme. *Pet. App. A23*. It is unclear whether petitioner seeks to challenge that determination in this Court (see *Pet. Reply Br. 4*), but in any event that fact-bound ruling does not warrant review. Thus, the question of the standards of liability applicable in "pure inaction" cases is not presented here. For that reason, petitioner's reliance (*Pet. 14*) on *Chiarella v. United States*, 445 U.S. 222 (1980), is misplaced, because this case involves affirmative action, not mere inaction and silence.

<sup>16</sup> Several courts of appeals expressly relied on the common law in concluding that recklessness could constitute scienter under Section 10(b). See *Mansbach*, 598 F.2d at 1024; *Sundstrand*, 553 F.2d at 1044; *Hackbart*, 675 F.2d at 1118.

<sup>17</sup> In *Hochfelder*, the Court recognized that "[i]n certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act." 425 U.S. at 194 n.12. In addition, the Court described scienter as "knowing or intentional misconduct," *id.* at 197, indicating that something less than conscious intent can suffice to establish scienter. As one court has observed, "'[k]nowing' is a word laden with common law connotations: at common law, reckless conduct is viewed as a form of knowing conduct." *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d at 45. Thus, *Hochfelder* supports the conclusion that recklessness satisfies the scienter requirement under Section 10(b) and Rule 10b-5: "Since there is no hint in *Hochfelder* that the Court intended a radical departure from accepted Rule 10b-5 principles, it would be highly inappropriate to construe the Rule 10b-5 remedy to be more restrictive in substantive scope than its common law analogs." *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d at 1044 (footnote omitted).



disregard of the potentially harmful consequences of his actions is just as culpable as one who acts with actual knowledge of the potential consequences.<sup>18</sup> That rationale is fully applicable to aiding-and-abetting cases.

Moreover, practical necessities require general application of a recklessness standard to aiding-and-abetting cases. Proving a defendant's actual knowledge of fraud can be a daunting task, particularly when (as is frequently the case) the evidence is entirely circumstantial. The Securities and Exchange Commission (SEC) and private parties routinely rely on recklessness in order to avoid this difficulty of proof. To insist on actual knowledge as the sole means of establishing scienter would permit much deliberately wrongful conduct to escape liability under the securities laws. See, e.g., *Rolf*, 570 F.2d at 47 ("To require in all types of 10b-5 cases that a factfinder must find a specific intent to deceive or defraud would for all intents and purposes disembowel the private cause of action under § 10(b)."); *Mansbach*, 598

<sup>18</sup> In the leading common-law case, *Derry v. Peek*, 14 App. Cas. 337 (H.L. 1889), the House of Lords stated that

fraud is proved when it is shewn that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. \* \* \* [I]f I thought that a person making a false statement had shut his eyes to the facts, or purposely abstained from inquiring into them, I should hold that honest belief was absent, and that he was just as fraudulent as if he had knowingly stated that which was false.

See also *Lehigh Zinc & Iron Co. v. Bamford*, 150 U.S. 665, 673 (1893) ("a person who makes representations of material facts, assuming or intending to convey the impression that he has actual knowledge of the existence of such facts, when he is conscious that he has no such knowledge, is as much responsible for the injurious consequences of such representations, to one who believes and acts upon them, as if he had actual knowledge of their falsity").

F.2d at 1025 ("Requiring a plaintiff to show that the defendant acted with actual subjective intent to defraud could impose a great burden upon recovery, greatly limiting the § 10(b)/Rule 10b-5 claim."). A recklessness standard is thus necessary to maintain the effectiveness of both the SEC's enforcement program and private actions. In view of the well-established principle that the securities laws should be construed liberally to effectuate their remedial purposes (see, e.g., *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972); see also *Reves v. Ernst & Young*, 494 U.S. 56, 60-61 (1990)), recklessness should generally satisfy the scienter requirement.

b. The question whether recklessness suffices to establish scienter for aiding-and-abetting liability warrants review by this Court. Although the decision of the court of appeals on this issue is correct, and is consistent with a recent decision of the Ninth Circuit, see *Levine v. Diamanthuset, Inc.*, 950 F.2d at 1484-1485 & nn. 4-5,<sup>19</sup> the court's decision conflicts with the decisions of other courts of appeals that have adopted different approaches in this area. In particular, some courts have held that, in the absence of a duty to disclose, a defendant cannot be held liable for aiding and abetting a violation of Section 10(b) without a showing of conscious intent to defraud. See *Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990); *Schatz v. Rosenberg*, 943 F.2d 485, 496 (4th Cir. 1991); cf. *Camp v. Dema*, 948 F.2d 455, 462

<sup>19</sup> The result reached by the court of appeals in this case is also consistent with the decisions of those courts that have suggested that recklessness would satisfy the scienter requirement in all Section 10(b) aiding-and-abetting cases. See *Herm v. Stafford*, 663 F.2d 669, 684 (6th Cir. 1981); *DCD Programs, Ltd. v. Leighton*, 833 F.2d 183, 188-189 (9th Cir. 1987); cf. *Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1123, 1126 (7th Cir. 1990), cert. denied, 111 S. Ct. 1317 (1991) (indicating that recklessness standard applies to all aiding-and-abetting claims under Seventh Circuit's test for aiding-and-abetting liability).

(8th Cir. 1991) ("Because [defendant] did not owe [plaintiff] a duty to disclose, the knowledge requirement may not be satisfied by recklessness."); *id.* at 463.<sup>20</sup> Under the test for aiding-and-abetting liability announced by those courts, recklessness would not suffice to impose liability on petitioner as an aider and abettor.<sup>21</sup>

In addition, several circuits have applied what is known as the "sliding scale" approach, under which the degree of scienter required for aiding-and-abetting liability varies depending on the nature of the defendant's conduct and the presence or absence of a duty to disclose.<sup>22</sup> Under that approach, a defendant who acts affirmatively to as-

<sup>20</sup> But see *FDIC v. First Interstate Bank*, 885 F.2d 423, 432-433 (8th Cir. 1989) (applying recklessness standard where defendant actively assisted the fraudulent scheme, despite apparent absence of duty to disclose to plaintiff).

<sup>21</sup> Unlike the court of appeals in this case (see Pet. App. A23-A25; see also *FDIC v. First Interstate Bank*, 885 F.2d at 433), the courts in *Schatz*, *Ross*, and *Camp* did not expressly address the question whether the level of scienter required for aiding-and-abetting liability should depend on whether a defendant assists the primary violation through affirmative action rather than through inaction and silence. In each of those cases, however, the defendant engaged in affirmative conduct that assisted the fraudulent scheme in some way, so those decisions must be viewed as rejecting the distinction relied upon by the court of appeals below. See *Schatz*, 943 F.2d at 489, 494 (defendant attorneys drafted closing documents that contained misrepresentations); *Ross*, 904 F.2d at 821-822 (defendant stock clearing agent took steps to terminate relationship with primary violator, but then rescinded decision and continued clearing trades for primary violator, including the allegedly fraudulent trade giving rise to the lawsuit); *Camp*, 948 F.2d at 457-458, 462, 464 (one defendant voted to approve allegedly fraudulent transaction and otherwise assisted scheme; other defendant's "actions were those necessary to consummate the [allegedly fraudulent] sale of stock").

<sup>22</sup> See, e.g., *Woodward v. Metro Bank*, 522 F.2d 84, 95-97 (5th Cir. 1975); *Metge v. Baehler*, 762 F.2d 621, 624-625 (8th Cir. 1985), cert. denied, 474 U.S. 1057 and 474 U.S. 1072 (1986); *Schneberger v. Wheeler*, 859 F.2d 1477, 1480-1481 (11th Cir. 1988), cert. denied, 490 U.S. 1091 (1989).

sist a fraudulent scheme but who has no duty to disclose is liable for aiding and abetting only if the plaintiff can prove "conscious intent[,] unless the character and degree of the [defendant's] assistance is unusual, \* \* \* in which case recklessness will suffice." *Akin v. Q-L Investments, Inc.*, 959 F.2d 521, 531 (5th Cir. 1992). Thus, unlike the rule announced by the court of appeals in this case, the "sliding scale" approach does not automatically lead to a recklessness standard where the defendant owes no duty to disclose but engages in affirmative conduct that assists the underlying fraud.<sup>23</sup>

Accordingly, review is warranted to reconcile these conflicting decisions and to make clear that recklessness is the appropriate standard of scienter in all aiding-and-abetting cases in which the defendant has affirmatively acted to assist the primary violation in some way. We recognize that the interlocutory nature of the decision below militates against immediate review by this Court. See, e.g., *Brotherhood of Locomotive Firemen v. Bangor & A. R.R.*, 389 U.S. 327, 328 (1967) (per curiam); *Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916); *American Construction Co. v. Jacksonville, T. & K.W. Ry.*, 148 U.S. 372, 384 (1893).

<sup>23</sup> In this case, the court of appeals found that petitioner's conduct in agreeing to delay the independent review of the 1988 appraisal was unprecedented, and that the underlying transaction was not merely "the daily grist of the mill." Pet. App. A26, quoting *Woodward*, 522 F.2d at 97. Given these findings, it seems likely that the "sliding scale" approach would call for a recklessness standard on these facts as well, and thus the holding below is not directly inconsistent with the decisions adopting the "sliding scale" approach. Nonetheless, the rule adopted by the court of appeals below could lead to inconsistent results in other cases in which the defendant provided ordinary yet affirmative assistance to a fraudulent scheme. See, e.g., *Schneberger v. Wheeler*, 859 F.2d at 1480-1481 (under "sliding scale" approach, court refused to impose aiding-and-abetting liability on defendant who did not have "knowledge of fraud," even though defendant had affirmatively assisted the fraud to a "slight" degree).

Nonetheless, it is well-established that "where \* \* \* there is some important and clear-cut issue of law that is fundamental to the further conduct of the case and that would otherwise qualify as a basis for certiorari, the case may be reviewed despite its interlocutory status." R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* 225 (6th ed. 1986) (citing cases). The issue of law presented in this case is not likely to be sharpened by factual elaboration at trial, and the question is clearly one that would otherwise qualify as a basis for certiorari.

\* \* \* \* \*

In the almost two decades since this Court's decision in *Ernst & Ernst v. Hochfelder, supra*, numerous courts of appeals have addressed the question at issue in this case, and they have adopted at least three partially inconsistent approaches to its resolution. There is no indication that the conflict is lessening with time, or that further consideration by the lower courts will shed additional light on the issue. The question of the standards applicable to claims of aiding-and-abetting liability under Section 10(b) and Rule 10b-5 is one that arises frequently, and it is of great importance to the enforcement of the federal securities laws and the proper functioning of the Nation's financial markets. Accordingly, the petition for a writ of certiorari should be granted with respect to that issue.

## CONCLUSION

The petition for a writ of certiorari should be granted with respect to the second question presented, and denied in all other respects.

Respectfully submitted.

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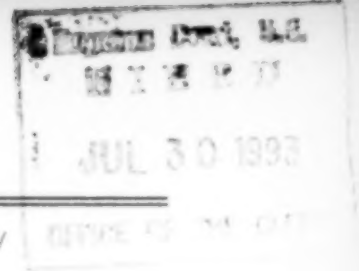
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MAY 1993





In The  
**Supreme Court of the United States**  
October Term, 1993

CENTRAL BANK OF DENVER, N.A.,

*Petitioner,*

v.

FIRST INTERSTATE BANK OF DENVER, N.A.  
AND JACK K. NABER,

*Respondents.*

On Writ Of Certiorari To The  
United States Court Of Appeals  
For The Tenth Circuit

JOINT APPENDIX

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Writ Of Certiorari Granted On 6/7/93

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**CHRONOLOGICAL LIST OF  
RELEVANT DOCKET ENTRIES**

- 7/25/89 - Lawsuit commenced
- 2/28/90 - Amended Complaint filed by Plaintiffs First Interstate Bank of Denver, N.A. and Jack K. Naber
- 3/20/90 - Answer by Central Bank and Trust Company of Denver to Amended Complaint of Plaintiffs
- 5/31/90 - Motion for Summary Judgment filed by Central Bank of Denver
- 6/6/90 - Brief in Support of Central Bank's Motion for Summary Judgment
- 6/18/90 - Brief by Plaintiffs First Interstate Bank of Denver, N.A. and Jack K. Naber in Opposition to Central Bank's Motion for Summary Judgment
- 6/20/90 - Reply by Defendant Central Bank to Plaintiffs' Brief in Opposition to Central Bank's Motion for Summary Judgment
- 6/26/90 - Order on Motions for Summary Judgment. Motion for Summary Judgment of Central Bank is GRANTED
- 7/5/90 - Judgment entered in favor of Defendant Central Bank and Trust Company of Denver and against Plaintiffs First Interstate Bank of Denver, N.A. and Jack K. Naber
- 10/23/90 - Order Pursuant to Rule 54(b) Granting Motion for Final Judgment; Final Judgment is entered against Plaintiffs and in favor of Central Bank



- 10/30/90 - Notice of Appeal by Plaintiffs First Interstate Bank of Denver, N.A. and Jack K. Naber
  - 7/8/92 - Opinion filed by the Court of Appeals
  - 11/16/92 - Petition for Writ of Certiorari filed
  - 11/18/92 - Mandate from Court of Appeals; Judgment dated 7/8/92 reversing and remanding the Decision of the District Court
  - 12/1/92 - Recall of mandate from Court of Appeals
  - 12/1/92 - Notification from Court of Appeals regarding Petition for Writ of Certiorari filed in the U.S. Supreme Court on 11/16/92
  - 6/7/93 - Petition for Writ of Certiorari granted by U.S. Supreme Court
- 

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLORADO

Civil Action No. 89-F-1250

FIRST INTERSTATE BANK OF DENVER, N.A., and  
JACK K. NABER,  
Plaintiffs

v.

KIRCHNER MOORE & COMPANY, a subsidiary of  
Drexel Burnham Lambert Incorporated, HANIFEN  
IMHOFF, INC., THE COLORADO SPRINGS-STETSON  
HILLS PUBLIC BUILDING AUTHORITY, ROY I. PRING  
and THE CENTRAL BANK & TRUST COMPANY OF  
DENVER,

Defendants.

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Civil Action No. 89-F-1806

IDS HIGH YIELD TAX-EXEMPT FUND, INC.,  
Plaintiff

v.

KIRCHNER MOORE & COMPANY, et al.,  
Defendants.

---

AMENDED COMPLAINT OF PLAINTIFFS  
FIRST INTERSTATE BANK OF DENVER, N.A.  
AND JACK K. NABER

---

Plaintiffs submit the following for their Amended  
Complaint:

### NATURE OF THE CASE

1. This is an action by plaintiffs First Interstate Bank of Denver, N.A. and Jack K. Naber relating to the bond issue known as the "Colorado Springs-Stetson Hills Public Building Authority Landowner Assessment Lien Bonds, Series 1988A" (the "1988 Bonds").

2. The issuer of the Bonds, the Colorado Springs-Stetson Hills Public Building Authority (the "Authority"), is a Colorado non-profit corporation, incorporated for the principal purpose of financing the construction and acquisition of public improvements, ultimately to be conveyed to the City of Colorado Springs, within the Stetson Hills area.

3. Stetson Hills is a planned development comprised of residential and commercial property located in the northeastern part of Colorado Springs. The administration and control of the Authority's affairs is handled by the developer of Stetson Hills, the AmWest Development I Limited Partnership (the "Company" or "AmWest").

4. The Company's general partner is AmWest Development Corporation; the limited partners are Roy and Charlotte Pring. Mr. Pring and other members of his family had originally owned all of the property in Stetson Hills, and at the time of the offering of the 1988 Bonds still owned more than half of the land proposed to be included in the development.

5. The proceeds of the 1988 Bonds, which were issued in the aggregate principal amount of \$11,000,000,

after deducting issuance expenses and underwriting discount and after setting aside an amount required for a Reserve Fund, were to be used to reimburse the Company for its previous expenditures of approximately \$9.4 million for improvements in the development.

6. The 1988 Bonds were special, limited obligations of the Authority, payable from allocated assessment charges to be assessed on approximately 272 acres of property within the development. The assessments were payable by the Company when any of the property was sold. The property was subjected to a lien (the "assessment lien") to secure the Company's ultimate responsibility for the assessment charges and for carrying out its obligations under a Development Agreement with the Authority.

7. According to the Official Statement for the 1988 Bonds, the developer was to be required to maintain sufficient land subject to the assessment lien so that the discounted value of that property would remain equal to at least 160 percent of the assessment charges, i.e. at least 160 percent of the outstanding principal of the 1988 Bonds (the "160% test").

8. The Official Statement included, among other things, a summary appraisal purporting to show the estimated discounted value of the 272 acres pledged to the assessment lien.

9. The Company had the obligation to place additional land under the assessment lien if the value of the security were to fall below the 160% test.

10. Beginning at least in early 1988, and by a course of conduct which was reckless and fraudulent and which will be alleged below in greater detail, defendants caused plaintiffs to invest in the 1988 Bonds, while concealing from plaintiffs facts showing not only that the payment of the 1988 Bonds was subject to additional materially adverse risks not disclosed in the Official Statement, but that the purported "security" for the Bonds, the 272 acres of property subject to the assessment Lien, was in fact inadequate: the defective methodology and assumptions used by the appraiser obtained by the defendants artificially created and maintained a market for the bonds; the appraisal had already been disapproved by at least one other appraiser who had reviewed the work, causing Central Bank as Trustee to request an independent review of the appraisal; this request for independent review was refused by the developer, resulting in a last-minute letter agreement, of May 13, 1988, in which the defendants agreed to go forward with the 1988 Bonds and to postpone appointment of a new appraiser until late 1988.

11. In fact by late 1988, seven months after the 1988 Bonds were issued, these and other risks related to the security and to the appraisal, materialized. The new appraiser selected to evaluate the security for the 1988 Bonds confirmed that far from being secured by property worth 160% of the outstanding bonds, the bonds were substantially under-collateralized. The market for the bonds dried up. The developer, by now in serious financial difficulty, refused to put more property under the Assessment Lien. The defendant underwriters ceased making a market in the Bonds. All of these events have

caused and continue to cause damage to First Interstate Bank and to Mr. Naber.

### JURISDICTION AND VENUE

12. Plaintiffs bring this action pursuant to §§ 10(b) and 20 of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. § 78j(b), § 78(t)], and Rule 10b-5 promulgated thereunder [17 C.F.R. § 240.10b-5]. This Court has jurisdiction of this action pursuant to § 27 of the Exchange Act [15 U.S.C. § 78aa]. Many of the acts charged herein, including the dissemination of the Official Statement for the 1988 Bonds, occurred in this district. In addition, all of defendants maintain offices within this district, and the defendants transacted business in this district.

13. In connection with the acts alleged in this Complaint, the defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including the mails and telephone communications and the facilities of national securities markets.

### PARTIES

14. Plaintiff First Interstate Bank of Denver, N.A. ("First Interstate") is a national banking association chartered and in good standing under the laws of the United States, with its principal place of business in Denver, Colorado. On or about June 16, 1988, First Interstate purchased \$2,100,000 of the 1988 Bonds. First Interstate now owns \$650,000 of these Bonds, the remainder of such



bonds being owned by customers who purchased the Bonds from First Interstate.

15. Plaintiff Jack Naber is an individual, residing in Lakewood, Colorado. On June 16, 1988, Mr. Naber purchased \$100,000 of the 1988 Bonds from First Interstate and \$25,000 of the Bonds from Drexel Burnham Lambert Incorporated. Mr. Naber continues to hold the Bonds, since there is no market for them.

16. Defendant Kirchner Moore & Company ("Kirchner"), a wholly-owned subsidiary of Drexel Burnham Lambert, Inc., is a Colorado corporation whose headquarters is in Denver.

17. At all relevant times, Kirchner has been engaged in the business of transactions in securities, principally as a dealer and underwriter of tax exempt municipal and U.S. government obligations and other security issues.

18. Kirchner was the lead underwriter for the 1988 Bonds and was also an underwriter of the \$15,000,000 of Bonds issued by the Colorado Springs-Stetson Hills Public Building Authority in December of 1986 (the "1986 Bonds").

19. Defendant Hanifen Imhoff, Inc. ("Hanifen"), is a Colorado corporation, with offices in Denver.

20. Hanifen is a registered broker-dealer under the Securities Exchange Act of 1934. Hanifen was an underwriter, with Kirchner, of the 1988 Bonds.

21. Defendant Colorado Springs-Stetson Hills Public Building Authority was incorporated in Colorado as a non-profit corporation on October 22, 1986. As of May 20, 1988, and thereafter, the Authority had no funds or assets

available for payment of debt service on the 1988 Bonds other than its rights to deposit the proceeds from the sale of the Bonds and to cause such proceeds to be used for construction and acquisition of the Stetson Hills improvements.

22. At all relevant times, the day to day administration and management of the Authority's affairs were handled by the Company, pursuant to a Management Agreement between the Company and the Authority.

23. Defendant Roy I. Pring ("Pring") is a citizen of Colorado, residing in El Paso County. At all times material hereto, defendant Pring was a Vice-President and Director of AmWest Development Corporation ("AmWest"), the general partner of the developer AmWest Development I Limited Partnership. The Company was formed in 1985 to develop 2,140 acres of land then owned and ranched by defendant Pring and other members of the Pring family, in the Stetson Hills area northeast of Colorado Springs. As of May 20, 1988, the date of the prospectus for the 1988 Bonds, defendant Pring and his wife owned 35 percent of the Company and directly and indirectly controlled an additional 13 percent through their interest in a Pring family investment entity.

24. At all relevant times, the Company administered and managed the affairs of the Authority, which was the issuer of the 1988 Bonds, pursuant to a Management Agreement. In addition, as of May 20, 1988 defendant Pring was also a principal creditor of the Company, to the extent of more than \$5,000,000.

25. As of May 20, 1988, defendant Pring and his family also owned all of the property in Stetson Hills

which had not yet been sold to the Company or to other builders or users, and which was expected to be available as additional security for the 1988 Bonds in the event that the Company was required to subject additional land to the assessment lien in order to satisfy the 160% test.

26. Defendant Pring, by reason of his ownership interest both in the Company and in the general partner of the Company, by reason of his management position in the Company which in turn controlled the day-to-day activities of the Authority as the issuer of the Bonds, and by reason of his membership on the Company's Board of Directors, was a controlling person of the issuer within the meaning of § 20 of the Exchange Act and had the power and influence, and exercised the same, to cause the issuer to engage in the illegal practices complained of herein.

27. Because of his positions, and because of the legal and practical influence of those positions, defendant Pring had access to adverse nonpublic information about the issuer and the Company, and about their business and financial condition and future prospects, as is more particularized below.

28. Defendant The Central Bank & Trust Company of Denver ("Central Bank") is a Colorado corporation with its offices in Denver. Central Bank was the bond trustee for both the 1986 Bonds and the 1988 Bonds.

29. Both Kirchner and Hanifen, in part through their counsel, conducted or participated as part of the 1988 Bond offering, in investigations, known as "due

diligence" investigations, into the business history, operations and prospects of the Company, including investigation of the value of the land owned by the Company and pledged as security for the 1988 Bonds. In the course of such investigations, the defendant underwriters either obtained knowledge of, or recklessly disregarded, the facts set forth in paragraph 42 below.

(a) The defendant underwriters were agents of the issuer, and of the Company, through which the 1988 Bonds were sold to plaintiffs. The defendant underwriters pursued a common course of conduct and aided and abetted the course of conduct and material omissions complained of herein, in part to obtain their share of the fees from the offering proceeds.

(b) A conspiracy, common enterprise and common course of conduct commenced prior to the May 20, 1988 offer of \$11,000,000 of the 1988 Bonds and involved the individual defendant, the underwriters, the Company as developer and the Authority. These actors agreed upon and pursued the conspiracy, common enterprise and common course of conduct complained of herein. The purpose and effect of the conspiracy, common enterprise and common course of conduct complained of was, among other things, to obtain money from the investing public in violation of the anti-fraud provisions of the federal securities laws. Defendants accomplished their conspiracy, common enterprise and common course of conduct by selling the 1988 Bonds to the public in the May 1988 public offering, and by thereafter artificially maintaining the price of the Bonds in the after market, all through the



continuing reckless and fraudulent concealment of the facts set forth in paragraph 42 below.

(c) The proceeds of the offering of the 1988 Bonds were divided, directly or indirectly, among the participants in the illegal course of conduct as follows:

(1) By the Authority receiving the proceeds in order to acquire the improvements from the Company;

(2) By the Company receiving, in turn, the proceeds from the sale of the improvements, to fund its previously incurred obligations so that it would be in a position to earn a substantial profit from marketing the Stetson Hills properties;

(3) By Pring receiving on or about June 16, 1988, the closing date, the sum of \$1,966,000, since he was not willing to extend further credit to his development project;

(4) By the underwriter defendants obtaining fees for bringing about the offering and for promoting the bonds in the after-market.

30. The underwriter defendants, defendant Pring, and the issuer were each a direct, necessary and substantial participant in the conspiracy, common enterprise and common course of conduct complained of herein. Each of them aided and abetted and rendered substantial assistance in the accomplishment of the fraud complained of herein. Each acted with an awareness of the primary wrongdoing, each realized that its/his conduct was of substantial assistance in the accomplishment of that

fraud, and each was aware of its/his overall contribution to and furtherance of, the conspiracy, common enterprise and common course of conduct.

### FACTUAL ALLEGATIONS

31. On November 25, 1986, the Colorado Springs-Stetson Hills Public Building Authority issued its Series 1986A Bonds, totalling \$15,000,000. The purpose of this issue, like the purpose of the 1988 Bonds, was to reimburse the Company for expenses which it had incurred in the construction and engineering of public improvements in Stetson Hills.

32. Defendant Kirchner was an underwriter of the 1986 Bonds.

33. The managing underwriter of the 1986 Bonds was Dain Bosworth. Dain Bosworth was not involved in the 1988 Bond offering. While all of the reasons for this are not presently known to plaintiffs, upon information and belief, the principal reason was that by the Fall of 1987 Dain Bosworth had become increasingly alarmed because of information, which was not known to plaintiffs, regarding continuing failures of the developer to meet the Bond covenants in the agreements related to the 1986 issue, and regarding deficiencies in the security and the calculation of the security for the 1986 Bonds.

34. As with the 1988 Bonds, the Official Statement for the 1986 Bonds had represented that the Bonds were to be secured at all times by an assessment lien on property owned by the developer, totalling approximately 250 acres for the 1986 Bonds, the value of which would at all



times equal or exceed 160% of the assessment charges to be applied to payment of the Bonds.

35. In addition, under the Bond covenants the charges levied upon the sale of the 250 acres securing the offering were to be maintained in an amount not less than 110 percent of the principal amount of the bonds outstanding (a cash flow requirement referred to in the Official Statement as the "110% test").

36. The Company's ability to sell the lots in the acreage securing both the 1986 and 1988 offerings, and the continuing sufficiency of the security under the 160% test and of the charges being assessed under the 110% test, were material elements of both the 1986 and 1988 Bond offerings.

37. In connection with the 160% test and the 110% test, the developer was required both for the 1986 Bonds and the 1988 Bonds annually to satisfy the Trustee, Central Bank, that the assessment charges equalled 110 percent of the principal amount of Bonds outstanding, and to submit to the Trustee annually a qualified appraisal report showing that the property remaining subject to the assessment lien had an appraised value, under a distressed sale assumption, equal to 160 percent of the unpaid and outstanding allocated assessment charges.

38. For the 1986 offering, the appraisal prepared on December 8, 1986, reflected that the discounted value of the 250 acres securing the 1986 Bonds was \$24,511,000.

39. On or about June 16, 1988, under terms and conditions described in an Official Statement dated May 20, 1988, the Authority offered its second bond issue, the

1988 Bonds, in the amount of \$11,000,000. This issue was underwritten by defendant Kirchner and defendant Hanifen. The proceeds from the sale of the 1988 Bonds were to be applied in reimbursement of an additional \$9.4 million of expenses which had been incurred by the Company in connection with public improvements in the development of the Stetson Hills area.

40. The 1988 Bonds were to be paid, through a mechanism and procedure identical to that used in the 1986 Bonds, by assessment charges imposed on an additional (i.e. separate from the 1986 security) 272 acres of land owned by the Company in Stetson Hills.

41. Although the property securing the 1988 Bonds was different from the 250 acres securing the 1986 Bonds, since the same entity, the Company, would be obligated in connection with both Bonds, a default under one bond issue, as the Official Statement for the 1988 Bonds stated, "will be likely to produce a default under the other Bond issue."

42. After the issuance of the 1986 Bonds, and before June 16, 1988 when the 1988 Bonds were available for delivery, there occurred a series of material developments, not known or made known to plaintiffs, all affecting the risk of the 1988 bonds. Specifically, these facts and events included, at least, the following:

(a) Although the Official Statement for the 1986 Bonds required that a qualified appraisal report on the security for the 1986 Bonds be supplied annually, by the end of 1987 the Company had failed to satisfy this requirement;

(b) The Company during 1987, had made use of the Reserve Fund for the 1986 Bonds in a manner contrary to the purposes and procedures provided by the bond covenants, essentially treating the Reserve Fund as a source of interest-free financing;

(c) On January 4, 1988, appraiser Joseph Hastings, who had prepared an estimate of the property securing the 1986 Bonds, submitted, belatedly, the required annual reappraisal for the 1986 security, including in it an appraisal of the property securing the 1988 issue. On January 25, 1988, John E. Conrad, Senior Vice President of Dain Bosworth, which was the managing underwriter for the 1986 issue wrote a letter to Central Bank as Trustee of the 1986 issue, copies of which were provided to defendant Kirchner and defendant Hanifen. Among other things, the letter included a calculation of the 110 percent test and 160 percent test and stated the following:

"As you know the two most important covenants are the 110 percent test and the 160 percent test. For the 160 percent test we must rely on the appraisal which is now approximately 16 months old. However, the 110 percent test is a cash flow test that can easily be checked. It appears as though the Stetson Hills Public Building Authority has not met the 110 percent test since June of 1987 . . . the 160 percent test is probably not being met for the same reason . . . it is our opinion that based on your statement to us and based on the project analysis, in addition to a Reserve Fund deficiency the Stetson Hills Public Building Authority is not

meeting either the 110 percent or the 160 percent test."

(d) In or about May of 1988, and because of the fact that the 1986 security had not met the 160 percent test, the Company was compelled to add property to the 1986 assessment lien;

(e) Either because the property originally described in the January 4, 1988 appraisal as security for the 1988 Bonds was also insufficient, or else because the calculation of the required amount of the security was incorrect, additional property also was required to be subjected to the lien for the 1988 Bonds before May 20, 1988;

(f) On March 22, 1988, Central Bank wrote a letter to the attorney for the Company. Copies of the letter, were sent, or the information contained in the letter was made known, to defendant Kirchner, defendant Pring and defendant Hanifen. Among other things, the Central Bank letter stated the following:

"We have completed our review of the appraisal dated January 4, 1988 prepared by Joseph L. Hastings. As you know we have also had the appraisal reviewed by Ed Elmer of our lending area, who we consider to be our resident expert . . . in connection with Mr. Elmer's review he has spoken directly with Mr. Hastings by telephone regarding certain issues. Based upon our review, and the recommendation given us by Mr. Elmer, we will require in our capacity as Trustee, that an independent review of the appraisal be conducted by a different appraiser, which may be selected subject to our approval. It is our preference that



Zaleski and Associates be engaged if possible for this purpose . . . "

The letter identified multiple deficiencies in the appraisal conducted by Hastings, which was proposed to be used for both 1986 bonds the May 1988 security and which was in fact eventually used for such security, despite the deficiencies.

(g) On or about March 31, 1988, the Company refused to conduct or arrange for an independent review of the Hastings appraisal;

(h) The Summary Appraisal attached to the Official Statement for the 1988 Bonds failed to disclose that the January 4, 1988 appraisal was not prepared in conformance with the requirements of the Code of Professional Practice of the American Institute of Real Estate Appraisers;

(i) Real estate sales of single family residential property in El Paso County had declined materially in 1987, and this decline, which had continued during 1988 and was likely to persist, posed a material risk that the Company would not meet its sales projections and would not be able to supply additional property as collateral in the event of a deficiency in the 160% test;

(j) With the prior knowledge of the underwriter, the Company refused to initiate an independent review of the 1988 Bond appraisal but instead on a May 18, 1988 letter agreement with defendant Central Bank agreed that a new appraisal of the 1988 Bonds security would not be commenced until December 1988, when an appraiser other than Joseph Hastings, specifically Gerald Zaleski, would be retained;

(k) Defendant Pring, based upon his decision (also undisclosed to investors) to extend no further credit to his Stetson Hills development, had arranged to receive and did receive \$1,966,000 of the \$9.4 million paid to AmWest from the proceeds of the 1988 Bond sales. Also concealed from investors was the fact that this cash payment to Pring included payment for the collateral touted as security for the 1988 Bonds (but which AmWest had not been able to pay for, except by means of cash received from bond proceeds), and also payment for property now needed as additional collateral for the earlier, 1986 Bonds, that collateral having already dwindled below the "160% test";

(l) AmWest, already foundering because of disappointing sales and increasing cash flow problems, had been forced to call upon its line of credit at Capitol Federal Bank in order to replenish the 1988 Bond Reserve Fund, from which it had been compelled to draw in order to make the payments due in late 1987 on the 1986 Bonds.

43. The Official Statement for the 1988 Bonds was materially false and misleading in failing to disclose any and all of the adverse information set forth in paragraph 42 above and in making it appear that the appraisal for the 1988 Bonds was reliable, prudent and correct, and that the 1988 Bonds were amply secured by the purported value of the 272 acres subject to the assessment lien.

44. In accordance with the May 13, 1988 letter agreement, in about November of 1988 the Company hired Gerald Zaleski of Colorado Springs to provide an



updated appraisal report of the property securing the 1986 and 1988 Bonds.

45. In late 1988 Zaleski gave a preliminary estimate not only that the land securing the 1988 Bonds would not be worth 160% of the bonds, but that the land value was less than the principal amount of the outstanding bonds.

46. The Company then refused to authorize completion of the appraisal, and later indicated that it did not have funds to make required payments to keep the debt service current and did not have the ability to exercise its option to purchase additional land to add to the property securing the 1988 Bonds.

47. Early in 1989 defendant Kirchner retained an expert appraiser to review the work of Hastings and of Zaleski; this appraiser advised that more conservative assumptions than those used by Zaleski might be appropriate and indicated that if his own appraisal were completed it would probably show values substantially lower than Zaleski's estimates.

48. On April 7, 1989, defendant Kirchner advised at least some of its customers that it would purchase the 1988 Bonds at a price of 25 percent of face value and the 1986 Bonds at 50 percent of face value.

49. Other than the offer which Kirchner made to its own customers on April 7, there is presently no market for the 1988 Bonds held by the Plaintiff Class.

50. On April 10, 1989, Central Bank notified holders of the 1986 and 1988 Bonds that an event of default had occurred by virtue of refusal of the developer to provide the appraisal.

51. Upon information and belief, there are not funds in the developer's Reserve Account sufficient to pay interest beyond December of 1988; accordingly, the 1988 issue will be in monetary default on June 30, 1990.

52. Beginning at least in early 1988, each of the defendants individually and in concert engaged in or aided and abetted a plan, scheme and unlawful conspiracy and course of conduct, pursuant to which they knowingly and recklessly engaged in acts, transactions, practices and courses of business which operated as a fraud upon plaintiffs and other members of the Class including the concealment of material facts in connection with the 1988 Official Statement. The purpose and effect of such scheme was to sell the 1988 Bonds to the public in June of 1988, to perpetrate a fraud on the public in order fraudulently to conceal deficiencies and risks of the security for the bonds and to inflate the price of the Bonds, and to conceal adverse facts concerning the developer's financial condition and performance and future business prospects, and concerning the alleged "160 percent" security for the Bonds and the method of calculating the value and the required amount of the security.

53. Defendant Pring, because of his position of control and authority as an executive officer of the Company was able to and did directly or indirectly control the material content of the Official Statement.

54. Defendant Pring had a duty properly to disseminate accurate and truthful information with respect to the Developer's operations, financial condition and prospects, and with respect to the property allegedly securing

the 1988 issue and the method of calculating or appraising the value of the property.

55. Defendant Pring participated in the wrongdoing complained of in order successfully to market the Bonds with a view toward being able to use the proceeds to repay increasingly burdensome obligations of the Company, in order to protect his considerable personal financial stake in the Company.

56. Defendants Kirchner and Hanifen pursued the conspiracy, common enterprise and course of conduct with the other defendants and also aided and abetted and rendered substantial assistance in furtherance of the wrongdoing complained of herein.

57. The underwriter defendants, in part through their counsel, conducted or participated in investigations, known as "due diligence" investigations into the business, operations and future business prospects of the developer and into the security and the method of appraisal of the security for the 1988 issue.

58. In the course of such due diligence investigations, the underwriter defendants discussed the timing and terms of the 1988 offering, and of the contents of the Official Statement, and devised and agreed upon a common course of conduct and enterprise, i.e. the sale of the 1988 Bonds to the public, and the disclosures that would be made in the Official Statement and what information would be omitted therefrom.

59. Defendants Hanifen and Kirchner also aided and abetted and rendered substantial assistance in furtherance of the wrongdoing complained of herein. Both of

these underwriters had knowledge of, or recklessly disregarded, the facts which rendered the Official Statement for the 1988 issue misleading, and which are set forth in paragraph 42 above.

60. Hanifen and Kirchner were market makers in the 1988 Bonds. By their conduct and statements, they assisted in creating and maintaining the market for the Bonds and in concealing adverse information about the Bonds.

61. Central Bank aided and abetted and rendered substantial assistance in furtherance of the wrongdoing complained of herein.

62. Because of its role as Trustee of the 1986 Bonds, and because of its role in preparing to act as Trustee of the 1988 Bonds, Central Bank was well aware of the very substantial hazards connected with reliance upon Mr. Hastings' appraisal of the collateral for the 1988 Bonds. Such risks known to Central Bank included among other things the conclusion of Mr. Elmer, Central Bank's in-house appraiser, that the property values arrived at by Mr. Hastings were "unjustifiably optimistic."

63. Central Bank knew that the Official Statement for the 1988 Bonds held out Central Bank as the Trustee for those bonds.

64. Plaintiffs trusted that Central Bank would carry out responsibly its role as Trustee for the 1986 Bonds and as Trustee for the 1988 Bonds, and said trust was known or should have been known to Central Bank.



65. Despite the facts and its knowledge of the facts set forth in paragraphs 62-64 above Central Bank knowingly or recklessly took affirmative steps to postpone any independent review of the Hastings appraisal, and knowingly or recklessly failed to take reasonable steps to alert investors in the 1988 Bonds of any of the risks connected with the Hastings appraisal, of which Central Bank as Trustee was fully aware. By its acts and its failures to act, Central Bank thus aided and abetted the fraud complained of herein.

#### FIRST CLAIM FOR RELIEF

(Section 10(b) of the Exchange Act and Rule 10b-5 of the Securities and Exchange Commission)

66. Plaintiffs incorporate by reference their allegations contained in paragraphs 1 through 65 above.

67. This claim is asserted by plaintiffs against all defendants and is based upon §§ 10(b) and 20 of the Exchange Act, 15 U.S.C. §§ 78j(b) and 78t and Rule 10b-5 promulgated thereunder.

68. Beginning at least in early 1988, the underwriter defendants, Pring, and the Authority individually and in concert, engaged in and aided and abetted a plan, scheme and unlawful conspiracy and course of conduct, pursuant to which they fraudulently and recklessly engaged in acts, transactions, practices, and courses of business which operated as a fraud upon plaintiffs and other members of the Plaintiff Class, and omitted to state material facts, as set forth in paragraph 42 above, necessary in order to make the statements made in the 1988 Official Statement not misleading to plaintiffs.

69. Each of the defendants referenced in paragraph 68 participated in and joined in the alleged scheme and course of conduct specified above, and each is liable primarily for the aforesaid wrongful acts and particularly for the fraudulent omissions as specified in paragraph 42 above.

70. Defendant Pring is secondarily liable for the fraudulent omissions set forth in paragraph 42 above, since: (1) even if he himself did not prepare the Official Statement, he knowingly joined and participated in the conspiracy set forth above to conceal the true facts about the Company, about the 1988 Bonds and about the security for the Bonds; by acquiescing in and failing to correct the omissions set forth above, he committed acts in furtherance of the conspiracy, thereby rendering him liable for all wrongful acts committed during the conspiracy; (ii) due to his positions of control and influence specified in paragraphs 23 through 26 above, Pring was a control person within the meaning of § 20 of the Exchange Act and is therefore liable for all the acts of the issuer and of the Developer; and (iii) he is liable as an aider and abetter since he had knowledge of the true facts which were not disclosed in the Official Statement, and he rendered substantial assistance in the wrongdoing.

71. Defendants Kirchner and Hanifen are primarily liable under § 10(b) for knowingly or recklessly marketing the 1988 Bonds by means of the misleading Official Statement, and are secondarily liable for the reasons set forth in paragraphs 56-60 above.

72. The omitted facts would have been material to a reasonable investor in the 1988 Bonds.



73. Defendant Central Bank is secondarily liable under § 10(b) for its conduct in aiding and abetting the fraud, as set forth above.

74. As a result of the foregoing, the 1988 Bonds were marketed and the after market was artificially inflated or maintained; in ignorance of the false and misleading nature of the Official Statement, plaintiffs relied, to their damage, on the integrity of the market both as to the price and as to whether or not the Series 1988 Bonds were marketable in the first instance. Plaintiffs have suffered substantial damages as a result of the wrongs alleged herein.

WHEREFORE, plaintiffs pray for judgment, as follows:

(a) Awarding plaintiffs compensatory damages in an amount which may be proven at trial, together with interest thereon including prejudgment interest;

(b) Awarding such other and further relief as the Court may find just and proper.

#### JURY DEMAND

Plaintiffs respectfully demand trial by jury.

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Lakewood, Colorado 80227

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IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLORADO

FIRST INTERSTATE BANK (Civil Action No. 89-F-1250  
OF DENVER, N.A. and  
JACK K. NABER,

Plaintiffs,

vs.

KIRCHNER MOORE AND  
COMPANY, et al

Defendants,

---

IDS HIGH YIELD TAX- Civil Action No. 89-F-1806  
EXEMPT FUND, INC.

Plaintiff,

vs.

KIRCHNER MOORE AND  
COMPANY, et al

Defendants.

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CENTRAL BANK AND TRUST COMPANY  
OF DENVER'S ANSWER TO AMENDED COMPLAINT  
OF PLAINTIFFS FIRST INTERSTATE OF  
DENVER, N.A. AND JACK K. NABER

(Filed Mar. 20, 1990)

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Defendant, Central Bank and Trust Company of  
Denver, now known as Central Bank Denver, N.A. (here-  
inafter referred to as "Central Bank"), by and through its  
attorneys, Adam M. Dalmy and John E. Bush, hereby

answers the Amended Complaint of Plaintiffs First Inter-  
state Bank of Denver, N.A. and Jack K. Naber, as follows:

1. Central Bank admits the allegations in Paragraph 1.
2. Central Bank admits the allegations in Paragraph 2.
3. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 3 and therefore denies same.
4. Central Bank admits the allegations in the first sentence of Paragraph 4, but is without sufficient information or knowledge to form a belief as to the truth of the remaining allegations therein and therefore denies same.
5. Central Bank denies the allegations in Paragraph 5 to the extent they are inconsistent with the applicable Bond documents, which documents speak for themselves.
6. Central Bank denies the allegations in Paragraph 6 to the extent they are inconsistent with the applicable Bond documents, which documents speak for themselves.
7. Central Bank denies the allegations in Paragraph 7 to the extent they are inconsistent with the Official Statement and/or the applicable Bond documents, which documents speak for themselves.
8. Central Bank denies the allegations in Paragraph 8 to the extent they are inconsistent with the Official Statement and/or applicable Bond documents, which documents speak for themselves.
9. Central Bank denies the allegations in Paragraph 9 to the extent they are inconsistent with the applicable Bond documents, which documents speak for themselves.

10. Central Bank denies the allegations in Paragraph 10.
11. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 11 and therefore denies same.
12. Central Bank admits that jurisdiction and venue are correct in this Court but denies all other allegations.
13. Central Bank admits that jurisdiction and venue are correct in this Court but denies all other allegations.
14. Central Bank admits the allegations in the first sentence of Paragraph 14, but is without sufficient information or knowledge to form a belief as to the truth of the allegations contained in the last sentence and therefore denies same.
15. Central Bank is without sufficient information or knowledge or [sic] form a belief as to the truth of the allegations in Paragraph 15 and therefore denies same.
16. Central Bank admits the allegations in Paragraph 16.
17. Central Bank admits the allegations in Paragraph 17.
18. Central Bank admits the allegations in Paragraph 18.
19. Central Bank admits the allegations in Paragraph 19.
20. Central Bank admits the allegations in Paragraph 20.
21. Central Bank admits the allegations in the first sentence of Paragraph 21, but is without sufficient information or knowledge to form a belief as to the truth of the remainder of the allegations therein and therefore denies same.

22. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 22 and therefore denies same.
23. Central Bank admits the first two sentences in Paragraph 23, but is without sufficient information or knowledge to form a belief as to the truth of the remainder of the allegations therein and therefore denies same.
24. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations contained in Paragraph 24 and therefore denies same.
25. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations contained in Paragraph 25 and therefore denies same.
26. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations contained in Paragraph 26 and therefore denies same.
27. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations contained in Paragraph 27 and therefore denies same.
28. Central Bank admits the allegations in Paragraph 28.
29. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations contained in Paragraph 29 and therefore denies same.



30. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations contained in Paragraph 30 and therefore denies same.

31. Central Bank denies the allegations in Paragraph 31 to the extent they are inconsistent with the applicable Bond documents, which documents speak for themselves.

32. Central Bank admits the allegations in Paragraph 32.

33. Central Bank admits the first two sentences of Paragraph 33, but is without sufficient information or knowledge to form a belief as to the truth of the allegations in the remainder of said Paragraph and therefore denies same.

34. Central Bank denies the allegations in Paragraph 34 to the extent they are inconsistent with the Official Statement and/or applicable Bond documents, which documents speak for themselves.

35. Central Bank denies the allegations in Paragraph 35 to the extent they are inconsistent with the applicable Bond documents, which documents speak for themselves.

36. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 36 and therefore denies same.

37. Central Bank denies the allegations in Paragraph 37 to the extent they are inconsistent with the applicable Bond documents, which documents speak for themselves.

38. Central Bank denies the allegations in Paragraph 38 to the extent they are inconsistent with the appraisal, which appraisal speaks for itself.

39. Central Bank denies the allegations in Paragraph 39 to the extent they are inconsistent with the Official Statement and/or applicable Bond documents, which documents speak for themselves.

40. Central Bank denies the allegations in Paragraph 40 to the extent they are inconsistent with the applicable Bond documents, which documents speak for themselves.

41. Central Bank denies the allegations in Paragraph 41 to the extent they are inconsistent with the Official Statement and/or Bond documents, which documents speak for themselves.

42. Central Bank denies Paragraph 42 and subparagraphs a to l of Paragraph 42 except that Central Bank admits that John E. Conrad wrote a letter to Central Bank dated January 25, 1988 and Central Bank wrote a letter to Greg Timm of Stetson Hills, and admits that property was added to the 1986 Assessment Lien to meet the 160% test on or about May, 1988.

43. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 43 and therefore denies same.

44. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 44 and therefore denies same.

45. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 45 and therefore denies same.

46. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 46 and therefore denies same.

47. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 47 and therefore denies same.

48. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 48 and therefore denies same.

49. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 49 and therefore denies same.

50. Central Bank denies Paragraph 50.

51. Central Bank denies Paragraph 51.

52. Central Bank denies Paragraph 52.

53. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 53 and therefore denies same.

54. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 54 and therefore denies same.

55. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 55 and therefore denies same.

56. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 56 and therefore denies same.

57. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 57 and therefore denies same.

58. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 58 and therefore denies same.

59. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 59 and therefore denies same.

60. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 60 and therefore denies same.

61. Central Bank denies Paragraph 61.

62. Central Bank denies Paragraph 62.

63. Central Bank denies Paragraph 63.

64. Central Bank denies Paragraph 64.

65. Central Bank denies Paragraph 65.

66. Central Bank denies Paragraph 66.

67. Central Bank denies Paragraph 67.

68. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 68 and therefore denies same.

69. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 69 and therefore denies same.

70. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 70 and therefore denies same.

71. Central Bank is without sufficient information of knowledge to form a belief as to the truth of the allegations in Paragraph 71 and therefore denies same.

72. Central Bank denies Paragraph 72.

73. Central Bank denies Paragraph 73.

74. Central Bank is without sufficient information or knowledge to form a belief as to the truth of the allegations in Paragraph 74 and therefore denies same.

#### FIRST AFFIRMATIVE DEFENSE

The claim against Central Bank fails to state a claim upon which relief can be granted.

#### SECOND AFFIRMATIVE DEFENSE

Plaintiffs' damages, if any, were caused by the negligence of Plaintiffs and in particular First Interstate Bank of Denver, N.A. (hereinafter referred to as "First Interstate") or the acts, omissions or negligence of the third parties other than Central Bank.

#### THIRD AFFIRMATIVE DEFENSE

Plaintiffs would be unjustly enriched if granted the relief which they seek.

#### FOURTH AFFIRMATIVE DEFENSE

Plaintiffs' claims are barred by First Interstate's own fraud and/or its own violation of state or federal securities laws.

#### FIFTH AFFIRMATIVE DEFENSE

Plaintiffs' claims are barred by the applicable Statute of Limitations.

#### SIXTH AFFIRMATIVE DEFENSE

Plaintiffs' knew or should have known of the alleged misrepresentations and omissions and their claims are barred by its assumption of risk, and Plaintiffs are estopped to assert a claim against Central Bank.

#### SEVENTH AFFIRMATIVE DEFENSE

Plaintiffs' claims are barred by laches.

#### EIGHTH AFFIRMATIVE DEFENSE

Plaintiffs failed to litigate their damages, if any.

#### NINTH AFFIRMATIVE DEFENSE

Plaintiffs' claims are barred by waiver and estoppel.

#### TENTH AFFIRMATIVE DEFENSE

Plaintiffs' claims are barred by the Doctrine of Unclean Hands.

#### ELEVENTH AFFIRMATIVE DEFENSE

Central Bank acted in a prudent manner, faithfully performing its duties under the Indenture of Trust, using



the same degree of care and skill as a prudent man would exercise or use under the circumstances in the conduct of its own affairs, and owed no duty to Plaintiffs except as stated in the 88 Indenture of Trust and only after Central Bank executed the 88 Indenture of Trust.

#### TWELFTH AFFIRMATIVE DEFENSE

Central Bank acted in good faith in reliance upon opinion and advice of counsel.

#### THIRTEENTH AFFIRMATIVE DEFENSE

Central Bank, pursuant to the Indenture of Trust, was entitled to and did in fact rely upon certificates signed by the Authority, Amwest and others as sufficient evidence of facts contained therein.

#### FOURTEENTH AFFIRMATIVE DEFENSE

First Interstate had equal access to the Information and facts which Plaintiffs' claims were misrepresented and/or omitted.

#### FIFTEENTH AFFIRMATIVE DEFENSE

Plaintiffs' claim against Central Bank is barred because of Central Bank's lack of knowledge.

#### SIXTEENTH AFFIRMATIVE DEFENSE

Central Bank made no false statements or representations.

#### SEVENTEENTH AFFIRMATIVE DEFENSE

Plaintiffs' reliance upon the alleged misrepresentations, if any, were not reasonable or justified and Plaintiffs' claim is barred by its own independent investigation of facts.

#### EIGHTEENTH AFFIRMATIVE DEFENSE

Plaintiffs failed to exercise due diligence and care in purchasing their Bonds.

#### NINETEENTH AFFIRMATIVE DEFENSE

Plaintiffs' damages, if any, were caused by factors over which Central Bank had neither responsibility nor control.

#### TWENTIETH AFFIRMATIVE DEFENSE

Plaintiff, Naber's damages, if any, were caused by First Interstate.

#### TWENTY-FIRST AFFIRMATIVE DEFENSE

Plaintiffs have failed to satisfy the conditions precedent to their right to the relief requested.

#### TWENTY-SECOND AFFIRMATIVE DEFENSE

First Interstate knew, or should have known, or recklessly disregarded the facts which allegedly rendered the

Official Statement misleading and/or the misrepresentations and/or omissions alleged by Plaintiffs and failed to disclose to Plaintiff, Naber, and its other customers, and their damages, if any, were the direct and proximate result of First Interstate's actions and/or omissions.

#### TWENTY-THIRD AFFIRMATIVE DEFENSE

First Interstate aided and abetted and rendered substantial assistance in furtherance of the allegations complained of in the Amended Complaint and First Interstate knew or recklessly disregarded said facts or omissions and failed to disclose same to its customers and is the proximate cause of Plaintiff, Naber's damages, if any.

WHEREFORE, Central Bank requests that this Court dismiss with prejudice the Amended Complaint of Plaintiff against Central Bank, that Plaintiff take nothing by way of Its Complaint against Central Bank, and that Central Bank be awarded its costs, attorneys' fees and such other and further relief as this Court deems just and proper.

Respectfully submitted,

/s/ Adam M. Dalmy  
 ADAM M. DALMY, Reg. No. 8681  
 JOHN E. BUSH, Reg. No. 4673  
 CENTRAL BANK DENVER, N.A.  
 P. O. Box 5548, T.A.  
 Denver, Colorado 80217  
 Telephone: (303) 893-3456

#### IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLORADO

Civil Action No. 89-F-1250

FIRST INTERSTATE BANK OF DENVER, N.A., and  
 JACK K. NABER,

Plaintiffs,

vs.

KIRCHNER MOORE & COMPANY, et al.,

Defendants.

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#### CENTRAL BANK'S MOTION FOR SUMMARY JUDGMENT

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Defendant Central Bank & Trust Company of Denver ("Central Bank"), pursuant to Rule 56(b), Fed. R. Civ. P., hereby moves for summary judgment against Plaintiffs and their claims against Central Bank and as grounds therefor incorporates its brief in support of the motion and further states as follows:

1. Plaintiffs have sued several parties involved in the 1988 issuance of tax-exempt bonds relating to the Stetson Hills Development located near Colorado Springs, Colorado, claiming violations of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.

2. Central Bank, which acted as the Indenture Trustee on the 1988 bond issue, is accused in Plaintiffs' Amended Complaint of aiding and abetting the alleged primary securities fraud violations of other parties involved in the transaction, including the underwriters,

the issuer of the bonds and a principal of the developer of the subdivision.

3. To be found liable as an aider and abettor, Plaintiffs must allege and prove, among other things, that Central Bank had a conscious intent to further the alleged violation and that it breached a duty to act.

4. Pursuant to the Trust Indenture Act of 1939, 15 U.S.C. § 77aaa-77bbbb, as well as the Indenture of Trust, under which Central Bank acted in this transaction, Central Bank's duties are extremely limited. Specifically, Central Bank has no duty to make the disclosures or to take the actions which Plaintiffs allege were lacking here.

5. Plaintiffs have not alleged, nor could they under the undisputed facts of this case, that Central Bank has a conscious intent to further the alleged fraud.

6. Thus, as a matter of law, Plaintiffs cannot prove that Central Bank is liable as an aider and abettor under the undisputed facts of this case.

Dated this 31st day of May, 1990.

IRELAND, STAPLETON, PRYOR  
& PASCOE, P.C.  
Tucker K. Trautman  
Neal S. Cohen  
Polly A. Atkinson

By /s/ Tucker K. Trautman  
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IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLORADO

DEPOSITION OF EDGAR J. ELMER January 22, 1990

Civil Action No. 89-F-1250

\* \* \*

Q [46] So is it fair to say that you do not recall another situation in which you were asked to review an appraisal relating to a bond issue in which Central Bank was acting as trustee?

A That's fair to say, yes.

\* \* \*

Q [153] (BY MR. HATCH) But let's go back. I mean, keeping in mind your testimony that on - in March of 1988, it was your opinion that the Hastings appraised values appeared to be optimistic -

A Could be optimistic.

Q Are you changing your testimony now?

A I am saying that the objections I had in that were "unjustifiably" and "investigation." They appear to be - they could be - I guess there is a definition in terms of could be or appear to be - optimistic in light of the market conditions at the time.

Q And has anything happened between March 22, 1988, and today that would change your opinion that the values determined by Mr. Hastings appeared to be optimistic?

A No.

\* \* \*

Q [124] At this meeting, did you suggest to her that the appraisal be reviewed by an independent appraiser?

A I am not sure I suggested it at this meeting or - I am sorry - at that particular meeting or at some other time in conversation, either on the telephone or in a meeting format, I think I did recommend that an independent outside appraiser be hired to review it.

Q Had you essentially come to that conclusion after your review of the appraisal?

A Well, partly as a result of that. The fact that I had these questions that had been raised in my review, and the fact that I didn't have the opportunity or the time, by any stretch of the imagination, to attempt to do a detailed review of the report, I felt I had to make a recommendation of an outside appraiser.

DEPOSITION OF KENNETH B. BUCKIUS

January 17, 1990

Volume I

Civil Action No. 89-F-1250

\* \* \*

Q [52] (BY MR. NETZORG) What did you find out?

A That he had followed that methodology.

Q How did you determine that he had followed that methodology?

A We received a certification from Mr. Hastings.

Q Any other ways that you determined it?

A No. We are entitled to rely on that.

(Mr. Dalmy conferred with deponent off the record.)

A (Continuing) Also, we had an in-house person who was an appraiser, and in conversations with him, he indicated that he felt the methodology had been followed.

Q (BY MR. NETZORG) When did he indicate that?

A Would have been late March or early April of '88.

Q Who was that?

A Excuse me?

Q Who was that in-house appraiser, Mr. Elmer?

A Mr. Elmer.

Q Did you talk to Mr. Elmer personally?

A [53] Yes.

Q On how many occasions, about this issue?

A Once.

Q When was that?

A I am not sure of the exact date. I don't recall the exact date.

Q Did - well, what did Mr. Elmer say to you in your conversation with him?

A I don't recall the exact particulars of the conversation.

Q Generally what did he say?

A It was a discussion with regards to what his concerns had been and a conversation he had had with Mr. Hastings. And he had initially had a concern about the methodology, but that that had been - that he felt, after talking to Mr. Hastings - I am not sure what else he did. But he felt that the methodology had been followed. More or less backed off from his concerns with regards to the methodology.

Q Was there anything else that he said to you?

A I really can't recall the specifics of the conversation. That was my main recollection.

\* \* \*

Q [134] So you didn't believe it was necessary for Mr. Hastings' report to comport with the qualified appraisal report definition set forth on Page 13 of the trust indenture, is that fair, Page - Exhibit 219?

A I had no reason to question Mr. Hastings' qualifications.

Q At what time? At any time?

A At any time.

Q You didn't have any reason to question his qualifications after Mr. Conrad raised all the questions about Mr. Hastings?

MR. CHASE: Objection. Mischaracterizes Mr. Conrad's correspondence.

A No. Mr. Conrad brought up concerns he [135] had - specific concerns with regards to comparables for - and methodology, I believe, and did not say anything with regards to the qualifications of Mr. Hastings.

\* \* \*

Q [288] Okay. Now, there was a meeting, apparently, as I understand it from the testimony to date, on March 31, 1988, where Mr. Timm discussed with you and, I think, Mr. Jeffers and Mr. Douglas the bank's requirement for an independent review of the appraisal.

Do you recall being at that meeting on March 31, 1988?

A I recall - I recall that meeting.

Q Okay. Do you recall that anyone else, other than the people I have just noted, were present at that meeting?

A I have notes on that meeting. Do you have a copy of those?

Q Look at Exhibit 74-A and tell me if those are your notes.

A (Deponent examined exhibit.)

Yes, they are.

Q Okay. Those are your notes?

A Yes.

Q Okay. And did you make them at the meeting, on March 31, '88, or did you make them after the meeting?

A I believe I made most of them during the meeting.

Q [289] Well, which portions of them, if any, did you make either before or after the meeting?

A I don't recall, the bottom portion under verification (indicating), when that was done.

Q Okay. Let's go through your notes. Okay?

KB stands for you?

A Myself.

Q GT is Greg Timm?

A No. Greg Timm is spelled out.

Q Well, in the fourth line -

A Oh, I'm sorry.

Q - of the notes - I'm ahead of you.

A Okay.

Q Okay. "GT willing to put up additional ground, \$2 million," what does that mean?

A Just that they were going to provide additional ground relative - the value would have been around 2 million.

Q Okay. Additional ground for what?

A It was to bring the tests into compliance.



Q For which deal?

A 1986.

Q And what was your response to that statement of Mr. Timm's?

MR. DALMY: At that time?

[290] MR. NETZORG: Yes.

Q (BY MR. NETZORG) All the questions I'm going to ask you right now are about what happened at the March 31, 1988 meeting. Okay?

A Okay.

Q So how did you respond?

A I don't believe I responded to each item individually.

Q Well, was there a dialogue that occurred at the meeting?

A I think it was a general discussion of what they were proposing.

Q Okay. And what was the discussion surrounding the issue of Mr. Timm being willing to put up an additional \$2 million in ground for the '86s?

A It surrounded the need to put - to have additional property subjected to the 1986 assessment lien, to bring the tests into compliance.

Q Okay. Now, Mr. Timm had stated, in January of 1988, January 27, if you look at Exhibit 65, that, quote, We are ready to immediately make these additions, referring to additional ground.

And why hadn't the land been put in immediately, as Mr. Timm had previously represented?

MR. CHASE: Object to the use of the word [291] "represented."

MR. NETZORG: As he had previously stated.

A I don't know.

Q (BY MR. NETZORG) Did you ask him why?

A I don't recall.

Q Okay. Now, the next line says, "doesn't want to do new appraisal and willing to ask Zaleski to do appraisal at end of the calendar year."

Is that right?

A That's correct.

Q What does that mean?

MR. RUH: Objection, foundation as to this witness' knowledge as to what Mr. Timm meant.

MR. NETZORG: I didn't ask what Mr. Timm meant.

MR. RUH: Well, I think it -

MR. NETZORG: I asked what the language he wrote down meant. If he doesn't have a foundation for that -

MR. RUH: Okay. I thought you meant what Mr. Timm meant by his knowledge.

Q (BY MR. NETZORG) What did you mean when you wrote that language down?

A I think it reflects their view that they didn't want to have a new appraisal performed at that [292] point in time and that they were proposing that, in order to avoid these kinds of problems in the future, that we could get - that we could have a calendar-year-end appraisal performed.

Q And what was your response?

A I don't recall that I had any response to that particular item at that time.

Q Were you familiar with the requirements of the '86 indenture on March 31, '88?

A Probably not off the top of my head.

Q Okay. Well, you knew, though, that, under the terms of the '86 indenture, that the trustee was able to select an appraiser out of a list of three for purposes of receiving a qualified appraisal report annually; isn't that right?

A The definition of qualified appraiser did provide that the trustee could select from a list of three.

\* \* \*

Q [295] And when we broke, isn't it the case that, as of March 31, '88, you knew that, as the trustee, you could require a qualified appraisal report at the end of the calendar year on the '86s?

A I don't know whether I knew that at that date or not, or whether I could recall it.

Q Okay. But it is a fact, though, as we've seen from the various documents, correct?

A [295] The documents state that the trustee can receive evidence satisfactory to it -

Q Of compliance -

A - of the 160 test. And the definition of the 160 test talks about a qualified appraisal.

Q Okay.

A There seems to be ambiguity there as to, as [296] I've stated before, it may be - a bring-down certificate might be sufficient.

Q Let's not leave out the bring-down certificate.

A Well, it's different -

Q I really don't intend to.

A It's different -

Q I know that's important to you.

A And it's different than an appraisal.

Q And it is different than an appraisal.

But nevertheless, even a bring-down certificate would start with a full-blown appraisal and work through the time that has elapsed between the appraisal and the date of the certificate, as you understand it; isn't that right?

A I believe so.

Q Okay. Now, Mr. Timm did offer to have Mr. Zaleski do the appraisal at the end of the calendar year, didn't he, in this meeting on March 31, '88?

A He stated in his proposal that he was willing to ask Mr. Zaleski.

Q [296] Okay. And Zaleski was the appraiser of preference expressed in Exhibit 72, the March 22 letter, right?

A (No response.)

Q [297] You recall that, don't you, without even looking at it?

MR. RUH: Objection as to form.

A 72?

Q (BY MR. NETZORG) Yes, 72.

A Yes. The Document 72 does state the preference.

Q Okay. Now, while you're on 72, isn't it also correct that, at the time that you approved the content of Exhibit 72, that Mr. Elmer had recommended an independent review of the appraisal to be conducted by a different appraiser?

MR. DALMY: I am going to object to that question as somewhat mischaracterizing the previous testimony.

MR. NETZORG: I'm asking a new question.

Q (BY MR. NETZORG): Isn't that the case?

A I didn't speak directly with Mr. Elmer. As to these items, my understanding is that he recommended an independent review of the appraisal.

Q Okay. Now, go back to Exhibit 74-A, your notes. And can you tell me what the next line, "did take into

consideration bulk sales in Hastings appraisal," what that means.

A It would mean that the methodology utilized [298] by Mr. Hastings did include the bulk sale, the methodology required under the documents.

Q And that's what Mr. Timm told you; is that right?

A That's correct.

Q Okay. Did you do anything to check that out, after this March 31, 1988 letter?

A I believe, as I testified, after this meeting, I did have a conversation with Mr. Elmer -

Q Okay.

A - where he indicated that the methodology followed was proper.

Q Now, does this set of notes help you place any more accurately the date of the conversation that you had with Mr. Elmer? And at least we can get to it had to be sometime -

A It would have been after this meeting.

Q Right. After the March 31 meeting, right? Can you get any closer?

A I believe I had written - I wrote a letter sometime in April. And it would have been prior to that.

Q Okay. Will you read the language that appears next to Comparables in Exhibit 74-A.

A (Deponent examined exhibit.)



[299] Okay.

Q Okay. What does it say? Could you read it out loud, please.

A Oh, I'm sorry.

"Many recent sales have been lender foreclosures. Hastings did consider the end-of-year sales to make sure they are in conformance."

Q And what did you understand -

Was this another statement made by Mr. Timm?

A I believe so.

Q What did you understand him to mean?

A That Mr. Hastings did look at more recent comparables.

Q Okay. What does "end-of-year sales" refer to?

A I don't know specifically.

Q Okay. Well, did you understand that Mr. Hastings had considered lender foreclosures in his appraisal?

A No. That's not my understanding.

Q You understood that he had not considered lender foreclosures?

A I don't know whether he did or didn't.

\* \* \*

Q [322] (BY MR. NETZORG) Don't focus on the definitional page. You see the first - the certificate of qualified appraiser. Skip the definitional page. And then

you see the signature page for the certificate of qualified appraiser. Okay?

A Right.

Q And is that Mr. Hastings' signature?

MR. CHASE: Objection, no foundation.

Q (BY MR. NETZORG): Do you believe it to be his signature?

A I assume so.

Q Okay. Do you recall having received this [323] letter from Mr. Hastings?

A I recall that we received it, yes.

Q Okay. When did you receive it?

A I don't know.

Q Okay. In this letter, Hastings does provide comfort as to his use of comparable sales, doesn't he, Paragraph No. 1?

A He does speak to the use of other comparable sales.

Q And based on his statements that he had reviewed other comparable sales, did you - excuse me - were you satisfied as to the concern which had been raised relating to comparable sales?

A As I recall, this gave us some comfort. But with regards to the amendment, we still required, I think, certification.

Q [323] Okay. Now, the second paragraph is comfort relating to bulk sale discount, correct?

A Yes.

Q As a result of having reviewed Paragraph No. 2, were you – were your concerns on the methodology for determining the bulk sale discount allayed?

A Again, it gave us – as I recall, it gave us some comfort. But as I stated, I recall that we [324] also continued to require certifications with the amendment.

\* \* \*

[336] Well, did this agreement, Exhibit 240, satisfy your concerns on having an appraiser who was acceptable to Central Bank to perform this December 1, 1988 appraisal?

MR. RUH: Objection, mischaracterizes the testimony as to acceptable appraiser.

A This agreement was to clarify what evidence would be satisfactory to us in the provision of the certifications as to the 110 and 160 test.

Q (BY MR. NETZORG) In your April 8th letter, you used the name of an appraiser, and that name was Zaleski. Right?

A That's correct.

Q Did that happen as a matter of coincidence, or was there a reason you used some appraiser's name?

MR. CHASE: Objection, asked and answered.

A As I mentioned before, the name was brought to us in the proposal by Mr. Timm – my understanding is that's because Mr. Zaleski had performed similar [337]

types of appraisals – and, number two, because Mr. Conrad had mentioned him.

Q (BY MR. NETZORG) And you also checked out his reputation with Mr. Elmer, didn't you, Mr. Zaleski's reputation with Mr. Elmer?

A I don't recall asking Mr. Elmer about Mr. Zaleski.

Q Do you know if Cherry Crandall did it?

A I don't know.

Q Okay. Did anybody, to your knowledge, check out Mr. Zaleski's reputation?

A I don't know.

Q Okay. But it was important to have the agreement, Exhibit 240, executed in advance of the closing of the '88s; is that right?

MR. DALMY: I am going to object to the term "important" as vague and ambiguous as to who or what.

A The agreement was done in order to clarify what we would require in the future, to avoid any confusion.

\* \* \*

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLORADO

DEPOSITION OF CHERYL ANN CRANDALL  
January 25, 1990

Civil Action No. 89-F-1250

Q [58] When was the first time that you became involved in a second Stetson Hills financing?

A. There were - I first recall some discussions about a second financing in very late 1987, I believe.

Q. [72] Was it your understanding early on in the deal, as early as you can recall, as to the second financing, that an appraisal would be provided that covered not only the already-issued bonds but the property to be included in the new bond deal?

A I understood that we would get appraisals for each issue, not an appraisal that covered both.

Q Not one appraisal?

A That's correct.

Q Okay. Now, were you surprised when you-all received - "you-all" meaning Central Bank - received the January 4, 1988 magnum opus - I refer to it that way; it's a very bulky document - appraisal by Mr. Hastings that referred to both the '86 property and property to be included in the second deal?

MR. DALMY: I'm going to object to the form of that question as "surprised" as being vague and ambiguous.

\* \* \*

Q [73] (BY MR. NETZORG) Well, in the typical way that -

A Well, I wasn't surprised. It simply wasn't adequate. I couldn't accept it. I needed them to be separate.

Q And what did you do when you received that?

A Advised Mr. Timm that I would need to have separate appraisals for each issue.

Q Okay. Did he have any problem with that?

A No.

Q Did you understand that Mr. Hastings would merely split out the '86 properties from the '88s?

A Yes.

Q Okay. And then you received certificates to that effect at some point later on, correct?

A Yes.

Q Okay. And I'll show those to you. And I think Mr. Buckius talked about them too. We'll see those later on. I tried to do it in order.

Will you look at Exhibit 145.

MR. CHASE: What is that, Skip?

MR. NETZORG: It's a December 10, '87 letter to Timm from Cherry. That's what it is.



Q (BY MR. NETZORG) Okay? And this letter starts out by confirming a telephone conversation [74] regarding the Cap Fed certificate maturities and the bond and reserve funds. And then there is a pretty detailed explanation of how much is where.

And then in the fourth paragraph, you tell Mr. Timm that there is a principal and interest payment due on December 30 of 654 grand. Do you see that?

A Yes.

Q Okay. Were you concerned, on December 10, '87, that that payment might not be made?

A No. I need to look at the indenture to recall. But I don't believe they had to make the payment until the day before the payment was due.

Q Okay. Now, you go on to say, unless that payment is due (sic), that amount will be transferred from the reserve fund to the bond fund on that date. Right?

A Right.

Q And then there is a requirement to replenish within 60 days.

A Right.

Q And did you understand that the Authority intended to use the reserve fund as a source of capital for that 60-day period?

A I had no understanding at all that -

They did not make the payment, and we did

\* \* \*

[75] use the reserve fund. But I had no understanding about what they had intended to do.

Q And then they did replenish it, didn't they?

A Yes, they did.

Q And did they replenish it in a timely fashion?

A Yes, they did.

Q And the source of the funds to replenish was from Cap Fed funds?

A I don't know where they came from. I don't recall. I mean -

Q There weren't sufficient house sales at that time - excuse me - lot sales at that time to produce that kind of revenue -

A No.

Q - were there?

A (Deponent shook head.)

\* \* \*

Q [80] Okay. And did that cause you any concern, that the values were approximately the same?

A I was curious. I expected to see some difference. But I wasn't concerned. I just noted that they were the same.

Q Okay. Well, you knew that the real estate market in Colorado Springs was in a state of decline?

A I did not know that. I had been advised that or heard of it and it had been discussed. But I didn't know that.

\* \* \*

Q [80] I'm not an expert on the English language, and I was using the word "knew" or "know" the way we do in common parlance.

Who had advised you that the real estate market was in a state of decline, when you received this appraisal?

A John Conrad had called me and advised me that, based on whatever work he had done, whatever sources were available to him, that he believed that there was a decline in property values in El Paso County.

\* \* \*

Q [84] Why did you have a conversation with Mr. Elmer?

A I had previously asked him to take a look at the appraisal that we had received from Mr. Hastings - by Mr. Hastings, received from the Authority.

Q And why did you ask him to look at the appraisal?

\* \* \*

A [84] There had been some questions raised. And not being knowledgeable or expert about real estate matters, I asked Ed to take a look at the appraisal and tell me whether or not he thought we should be concerned about anything.

Q Okay. What questions had been raised about the appraisal?

A Whether the comparable sales data that was used was current enough.

Q Okay. Any others?

A And whether or not a forced liquidation assumption had been used.

\* \* \*

Q [95] And then the next thing was that you asked Elmer to contact Hastings?

A Yes.

Q Okay. And then did you have a subsequent meeting with Elmer about his contact with Hastings?

A Yes.

Q Okay. And these notes, then, are really two meetings down the road with Elmer, right?

A These notes were after he had the telephone conference with Hastings that I asked him -

Q Right.

A - to have.

\* \* \*

Q [115] Okay. And as a result of your computation, you determined, as of January 31, 1988, that the 160 test was out of compliance; is that right?

A That is not right.

Q Well, didn't you determine -

A I didn't determine anything. This was an exercise for my benefit, in making sure that I had, conceptually, a good grasp of what these things meant.

Q When you did your exercise to determine - or to make sure that you conceptually had a good grasp, you computed the 160 test at 1.31, didn't you, ma'am?

A That was the number I worked to. Whether I was doing it directly, I don't know.

Q Okay. But that number was different than 160?

A That's correct.

Q It was less?

A Uh-huh.

Q So according to your own calculations, the 160 test was not coming up at 160 or more?

A That's correct.

Q And you did the 110 test and calculated it out at 1.33, right?

A Right.

\* \* \*

Q [125] Okay. Now, looking at the next page - it's Page 27, as it's numbered in the right-hand corner -- it is dated 2-10-88.

And again, looking at your calendar, it appears there was a meeting with Mr. Johnson, Mr. Timm, Mr. Camirand and yourself at Kutak, right?

A Right.

Q Okay. And are these notes of that meeting?

A Yes.

(Mr. Gersh entered the deposition room.)

Q (BY MR. NETZORG) And also, your notes actually indicate Mr. Jeffers was present at that meeting, as well; is that right?

A Yes.

\* \* \*

Q [129] Okay. Can you tell me what the nature of the discussions were surrounding both your question of validity of appraisal, as well as the comment of Mr. Timm.

A Well, my question was, "If land values, in fact, have declined" -

Q Okay.

A - "as a matter of common sense, one would expect that that new value would be something less than the original value."

Greg's comment was, "Well, they've remained substantially unchanged. But during that period of time, we've put \$10 million worth of improvements into the property."

Q Was there any verification of his statement that occurred at the meeting, in other words, documents or receipts that were looked at or anything to that effect?



A No.

Q Did you believe Mr. Timm when he said they put in \$10 million worth of improvements during that time frame?

A I didn't question him.

\* \* \*

[140] Is it your belief that Mr. Hastings used the same methodology in his appraisal as to all of the pieces of property in the appraisal?

A Yes. It's clearly prescribed under the documents what that methodology is to be.

Q Okay. And so if there were questions that related to the methodology, the questions would be directed not only at the methodology as it related to [141] the '86 pieces of property but also to the property to be included in the '88 deal; isn't that right?

A I wasn't particularly concerned about the '88 deal at that point in time.

Q Okay. I understand that. But what I've said is true, isn't it? It was true at that time, that, even though you weren't concerned, the questions that were raised applied equally, since the methodology was the same -

A No.

Q - to the '86 and '88?

A Because we weren't discussing the '88 issue.

\* \* \*

Q [161] Okay. Did anything occur between March 22, 1988 and June 16, 1988 that made you believe that the values determined by Mr. Hastings, in fact, were not unjustifiably optimistic?

A Quite honestly, you know, beyond this letter - after this letter, I was not terribly involved with the transaction. Ken Buckius was. So I just don't know.

Q Why did Ken Buckius step in after this letter, do you know?

MR. CHASE: Object on the grounds of foundation.

A I went to Ken. I needed some help with this deal. It was becoming very complicated, very time consuming. And I couldn't handle it alone.

Q (BY MR. NETZORG) Okay.

A I asked Ken to step in.

\* \* \*

Q [180] Then he says, "We shall be adding some additional ground as described in the appraisal which you will be receiving. We are ready to immediately make these additions," et cetera.

And did you believe that Mr. - or did you believe, as a result of having read Mr. Timm's letter, that yes, in fact, it was necessary to add new land to the '86 lien?

A [180] As I told you before, there had been discussions about whether or not the computations were correctly done.

Q Yes.

A And the - apparently, at this point in time, it was believed that land would have to be added.

Q And you didn't have any reason to doubt Mr. Timm if Mr. Timm himself thought that land had to be added, right?

A That's correct.

---

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLORADO

Civil Action No. 89-F-1250

FIRST INTERSTATE BANK OF DENVER, N.A., and  
JACK K. NABER,

Plaintiffs,

vs.

KIRCHNER MOORE & COMPANY, et al.,

Defendants.

---

AFFIDAVIT OF KENNETH B. BUCKIUS

---

STATE OF COLORADO     )  
CITY AND                     ) ss.  
COUNTY OF DENVER     )

I, Kenneth B. Buckius, hereby depose and state as follows:

1. I am the Manager of the Corporate Trust Department of Central Bank of Denver ("Central Bank") and have held that position since January 1986.

2. Central Bank acted as Indenture Trustee for two tax-exempt bond issues relating to Stetson Hills Development near Colorado Springs, Colorado. The first was \$15,000,000 of bonds issued in December, 1986 ("1986 Bonds"). The second was \$11,000,000 of bonds issued in June, 1988 ("1988 Bonds").

3. On June 15, 1988, Central Bank executed an Indenture of Trust ("Indenture") specifying the duties and rights of the trustee.

4. Sometime after January 4, 1988, Central Bank received an appraisal (dated January 4, 1988) performed by Joseph L. Hastings which combined properties securing the 1986 Bonds and properties proposed to secure the 1988 Bonds. At our request, Hastings separated the appraisals which Central Bank received in the first week of February, 1988.

5. Prior to becoming trustee on the 1988 Bonds, certain objective concerns relating to an appraisal performed by Hastings relating to property securing the 1986 Bonds were brought to Central Bank's attention by John Conrad of Dain Bosworth, Inc., the senior underwriter on the 1986 Bonds. Specifically, Mr. Conrad questioned whether the comparables used by Hastings were of recent enough vintage to make his values reliable. As a result, Central Bank had its in-house appraiser, Ed Elmer, perform a summary review of the appraisal. Mr. Elmer also had concerns relating to the comparables and questioned whether Hastings had followed the bulk sale methodology in a forced sale context as prescribed in the Indenture.

6. Thereafter, Cheryl Crandall, the trust officer responsible for Central Bank's duties relating to the 1986 Bonds, sent a letter dated March 22, 1988 to Greg Timm, a representative to the Stetson Hills Authority, setting forth the objective concerns relating to the appraisal and requesting that an independent review of the appraisal be performed.

7. On March 31, 1988, I met with Greg Timm, as well as Steve Jeffers and Will Douglas, representatives of Kirchner Moore & Company, the senior underwriter in the proposed 1988 Bonds. At the meeting, Timm informed me that Hastings had reviewed recent comparables and that they were in conformance with the values in the appraisal. Also, I was informed that Hastings had followed the prescribed bulk sale methodology in a forced sale context. Timm offered to obtain a letter or certifications from Hastings answering these concerns which would be satisfactory to the Bank. Finally, Timm suggested that a new appraisal would be performed by another appraiser by year end.

8. On or about April 5, 1988, the corporate trust committee of Central Bank met and discussed the Bank's original demand for an independent review of the Hastings appraisal, as well as Timm's proposal. The committee accepted Timm's proposal which I communicated by my letter of April 8, 1988. Based upon certifications by Hastings, an MAI appraiser accepted by Central Bank, Central Bank's objective concerns relating to the Hastings appraisal were resolved to its satisfaction.

9. On May 13, 1988, Central Bank executed a letter agreement with the Authority and the Developer which required that an appraisal be provided to Central Bank on an annual basis by Zaleski & Associates or another qualified appraiser acceptable to Central Bank related to the 1986 Bonds and the proposed 1988 Bonds.

10. In carrying out its duties of authenticating and delivering the 1988 bonds, Central Bank relied upon the Hastings appraisal relating to property securing those



bonds and certifications by Hastings concerning his review of recent comparables and the use of the bulk sale methodology, as well as certifications by the Authority and Developer concerning compliance with the 110% Test and 160% test and the proper use of proceeds. Central Bank considered that evidence to be satisfactory and the documents genuinely correct and to have been signed and sent by the proper persons as required by the Indenture. Thereafter, on June 16, 1988, Central Bank delivered the bonds as required by the Indenture.

11. Central Bank did not participate in the preparation of the preliminary or final official statements ("Official Statements") relating to the 1988 Bonds nor were representatives of Central Bank in attendance at drafting sessions concerning the Official Statements. Central Bank received drafts of the Official Statements but reviewed them only to assure that its name was properly stated.

12. Further, the affiant sayeth not.

/s/ Kenneth B. Buckius  
Kenneth B. Buckius

Subscribed and sworn to before me this 31st day of May, 1990.

WITNESS my hand and official seal.

/s/ Diane S. Filing  
Notary Public

My commission expires:

12-8-93

[SEAL]

(LOGO) **Central Bank**  
Denver

October 22, 1987

Phone #893-3456

Gregory D. Timm  
Stetson Hills  
5455 No. Union Boulevard  
Colorado Springs, CO 80918

RE: Stetson Hills Public Building Authority  
Landowner Assessment Lien Bonds Series 1986A  
Account Number 80-5021

Dear Greg:

As you may realize, we are soon approaching the anniversary date of the issue of the above Bonds. Certain items are required to be provided to the Trustee on an annual basis. This letter is to assist you in identifying those items which must be provided, and to give you sufficient advance reminder of them so that these items will be received by the Trustee in a timely manner.

The following are to be provided within 120 days of the end of the Company's fiscal year:

1. The Company's audit report and accompanying financial statements.
2. An independent public accountant's certificate concerning the required distributions of profits and earnings.

These items have not yet been received by the Trustee for fiscal year 1986.

1515 Arapahoe Street/Denver, Colorado 80292/  
(303) 893-3456

The following items are to be provided at least annually, and will therefore need to be in the possession of the Trustee prior to the end of calendar year 1987:

1. The Company's certification with respect to its compliance with all covenants under the Development Agreement and the Public Improvements Assessment and Lien.
2. The Company's certification setting forth the total number of parcels sold during the preceding year that were subject to the Lien, and the aggregate sales price received.
3. The Company's certification regarding an examination of the real property records of El Paso County containing the required information with respect to the payment of taxes and assessments, those that are due, and any delinquencies.
4. The Company's instructions to the Trustee for any required Rebate Deposit with the accompanying CPA report.
5. A Qualified Appraisal Report, as that term is defined in the Indenture, to provide satisfactory evidence to the Trustee that the 160% Test is being met. This report must have been prepared by a Qualified Appraiser within the previous three months. This report will be required prior to any further releases of property from the Lien by the Trustee.

Please refer to Section 5.3 of the Development Agreement and Section 5.11 of the Indenture for the specific requirements concerning all of the above items.

Please let me know if you have any questions in this regard or if I may be of any assistance.

Thank you for your cooperation and attention to this matter.

Cordially,

/s/ Cherry Crandall  
CHERYL A. CRANDALL  
Corporate Trust Officer

jj

cc: John Conrad, Dain Bosworth

(LOGO) Central Bank  
Denver

December 10, 1987

Greg Timm  
Stetson Hills  
5455 North Union Boulevard  
Colorado Springs, CO 80918

RE: Stetson Hills PBA  
Account Number 80-5021

Dear Greg:

This will confirm our telephone conversation today regarding the Capitol Federal certificate maturities in the Bond and Reserve Funds, and the December 30 debt service payment.

The Capitol Federal maturities are in the amounts of \$34,823.08 and \$735,153.98 for the Bond and Reserve Funds, respectively.

There is currently \$80,458.72 available in the Reserve Fund in excess of the requirement. This amount has been

1515 Arapahoe Street/Denver, Colorado 80292/  
(303) 893-3456

transferred to the Bond Fund, and results in a new available balance totalling \$118,247.58.

The principal and interest payment due on December 30 is \$654,875.00. Unless a prepayment is received prior to December 30 in the amount of \$536,627.42, such amount will be transferred from the Reserve Fund to the Bond Fund on that date. In the event that such transfer is made, you will be required to replenish the Reserve Fund within 60 days.

In accordance with your instructions, the funds received from the investment maturities today have been invested in the SEI Repo, and will remain so invested until applied to debt service or until you have provided further written instructions.

Additionally, my records indicate that the policy for general liability insurance has expired today. Please advise as to the status of a renewal policy.

Please also advise with respect to the status of the items requested in my letter of October 22. I understand that a new appraisal will be available sometime in January. We have also received the copies of your annual report.

Please let me know if you have any questions.

Best wishes for a happy holiday season.

Cordially,

/s/ Cherry  
CHERYL A. CRANDALL  
Corporate Trust Officer

jj

Jeffers

DEPOSITION EXHIBIT 61

11-29-89

AGREN, BLANDO & ASSOCIATES

Stetson Hills

Dec. 30, 1987

Greg Timm  
Greg Johnson

Mark Carlson  
Steven Pastrana

160% Test: presents problems so does not take into acc't  
the reserve fund

- \*1) should this be parity debt or not
- 2) advance refunding
- 3) reconizing [sic] that we cannot change the existing test - we create a new test which becomes effective when the 1986 bonds get defused (either economically or through an advance refunding)

- Greg T - Non parity debt - we will discuss it internally
- Will any bond proceeds be used for sites previously benefitted [sic]?  
yes
- talk to Hastings & Buckius about need for appraisal or whatever to support the 160% test certification
- closing no later than Feb. 20 preferably early Feb.
- Appraisal s/b done w/i 1 1/2 wks. do summaries
- sales schedule ASAP - Tuesday
- one other time constraint: January 19th start of Writer lawsuit
- January 8th Appr., Sales sch., use of proceeds, const. schedule

4th - January 12th new draft of documents, Cash Flows

Exhibit C



- January 15th review session 9:30
- January 19th 2nd Drafts
- January 21 (illegible) Mail
- Marketing shoot for the 9th but most realistic

February 23rd - City Council Mtg.  
Pre-Close 24th worst case

February 25th Closing

about 170 homes sold

G Timm - set up conference call w/Hastings - Jan. 4

#### Stetson Hills

- 1.) are they meeting all requirements w/Trustee?
- 2.) is the issue sigs going to \$11MM and if so when will appraisal be ready
- 3.) has Timm spoken w/Wilson?
- 4.) What is projected date for City Council hearing?
- 5.) Powers has a repurchase agreement w/amount at \$9,783/acre whereas projected liens = \$38,022/acre and appraisal in excess of \$56,864

Ms. Brenda Horn  
Ice Miller Donadio & Ryan

Dear Brenda:

Please find enclosed a program description package for presentation to the State Budget Office director, Ken Coby.

Johnson  
DEPOSITION EXHIBIT 257  
1-24-90 LO  
AGREN, BLANDO & ASSOCIATES

January 11, 1988

TO: ALL PERSONS ON THE ATTACHED DISTRIBUTION LIST

\$10,000,000  
THE COLORADO SPRINGS-STETSON HILLS  
PUBLIC BUILDING AUTHORITY  
Landowner Assessment Lien Bonds  
Series 1988A

Ladies and Gentlemen:

Enclosed for your review are initial drafts of an Indenture of Trust, Development Agreement and Public Improvements Assessment and Lien prepared in connection with the above-captioned financing. The enclosed documents have been prepared in the expectation that the Series 1988A Bonds will be issued as a series of Bonds which will be separate from the Series 1986A Bonds previously issued by the Authority. Accordingly, there are no cross-default or cross-collateralization provisions between the two series of Bonds.

We are awaiting receipt of certain additional information from the Company for inclusion in the Official Statement. At such time as the information is received, we will incorporate it into the Official Statement and distribute copies of that document for your review and comment. Our preliminary list of additional information required to complete the initial draft of the Official Statement is set forth below:

1. Copies of the appraisal report for the land to be pledged as security for the Series 1988A Bonds, as well as the appraisal report of the 1986A Bond issue.

2. Unaudited interim financial information concerning the Company and the Authority to supplement the audited financial statements dated December 31, 1986.

3. Copies of existing loan documents with Capital Federal Savings and Loan Association and any other lenders for the Company.

4. A report of sales activity within Stetson Hills since the date of the last Bond issue.

5. A real estate description describing the real estate to be encumbered under the Public Improvements Assessment and Lien, the number of acres to be encumbered, as well as a survey or other site plan identifying the location of that real estate.

6. A preliminary title report or commitment for title insurance with respect to land to be encumbered under the Public Improvements Assessment and Lien.

7. A map or other diagram identifying the type and location of the public improvements to be encumbered under the Public Improvements Assessment and Lien.

8. The information previously identified as required from the Company to complete various blanks in the Official Statement.

We look forward to receiving the foregoing items of information, as well as any comments you may have concerning the documents, at your earliest convenience.

Yours sincerely,

Gregory V. Johnson

kjp

Enclosures

\$10,000,000  
THE COLORADO SPRINGS-STETSON HILLS  
PUBLIC BUILDING AUTHORITY  
Landowner Assessment Lien Bonds  
Series 1988A

DISTRIBUTION LIST

Gregory D. Timm, Esq.  
 Mr. Marc A. Camirand  
 Stetson Hills  
 By AmWest Development Corporation  
 5455 North Union Boulevard  
 Colorado Springs, CO 80918

Mr. Steven D. Jeffers  
 Mr. William C. Douglas, Jr.  
 Kirchner Moore & Company  
 Suite 2700  
 717 17th Street  
 Denver, Colorado 80202

Mr. Kenneth B. Buckius  
 Central Bank of Denver  
 Tower 3, 5th Floor  
 1515 Arapahoe Street  
 Denver, CO 80202

Gregory V. Johnson, Esq.  
 R. Steven Pastrana, Esq.  
 Kutak Rock & Campbell  
 2400 ARCO Tower  
 707 17th Street  
 Denver, CO 80202

Jeffers  
 DEPOSITION EXHIBIT 64  
 11-29-89  
 AGREN, BLANDO & ASSOCIATES

(LOGO)  
 DAIN  
 BOSWORTH  
 INCORPORATED

INTER-REGIONAL FINANCIAL  
 GROUP

January 25, 1988

Ms. Cherry Crandall  
 Corporate Trust Department  
 Central Bank of Denver  
 5th Floor  
 1515 Arapahoe Street  
 Denver, Colorado 80202

RE: Stetson Hills Public  
 Building Authority

Dear Cherry:

You have advised us, as senior manager on a \$15,000,000 issue for the above issuer, that the Authority did not make its interest payment on December 30, 1987 and that you, acting in your capacity as Trustee, used

17TH STREET PLAZA BUILDING/SUITE 1800/1225  
 17TH STREET/DENVER, COLORADO 80202-5599  
 (303) 294-7200

Bond Reserve monies to make the payment to bondholders. You have further advised us that during the course of 1987, you released certain parcels of property from the Lien of the Indenture, based on certifications from one Greg Timm that the Authority was in compliance with its Bond Covenants. Computer reports from you, as Trustee, show that as of December 31, 1987, the Authority had no funds on deposit in the Bond Fund.

This is a complicated transaction. As you know, the two most important covenants are the 110% Test and the 160% Test. For the 160% Test we must rely on the appraisal which is now approximately 16 months old. However, the 110% Test is a cash flow test that can easily be checked. It appears as though the Stetson Hills Public Building Authority has not met the 110% Test since June of 1987, because property has not been added to the Lien of the Indenture. The 160% Test is probably not being met for the same reason.

Enclosed please find a copy of the project analysis which was done just prior to closing to satisfy Bond Counsel and Disclosure Counsel that the 110% Test was being met. You will note on page 8, that in order to meet the 110% Test in 1987, either \$3,854,865.00 of assessments should have been paid or land with sufficient value should have been added to the collateral. We are of the understanding, based on discussions with you, that neither occurred.

You will note on pages 2 and 3 that the following assessment rates are required to be in place on the various categories of land subject to the Lien of Indenture:



Non-Residential (P.I.P.)	\$ 81,790
Non-Residential (P.S.C.)	133,412
Single Family (R-1-6000)	22,347
Multi-family (P.U.D.)	597,192

We assume that you have checked the collateral to satisfy yourself that the recorded assessment liens have been correctly stated.

The fact that property was released from the Lien of the Indenture without the appropriate amounts being placed in the Bond Fund would suggest that you may have been given false or misleading certifications.

At this date we are operating on an appraisal that is over 16 months old. In light of the declining property values in Colorado Springs and the foreclosure sales, many of which have occurred within the vicinity of the collateral, an appraisal that reflects property values similar to those utilized for the 1986 appraisal of record should be suspect and not relied on without further independent check. As Trustee, you have the authority to name an independent appraisal if you are not satisfied.

It appears that the officers of the Stetson Hills Building Authority have failed to conform to the Bond Covenants to which they agreed. In the interest of the bondholders I call upon you to enforce the covenants or Invoke the Remedies. It is our opinion that, based on your statement to us and based on the project analysis, in addition to a reserve fund deficiency the Stetson Hills

Public Building Authority is not meeting either the 110% or the 160% Test.

Respectfully submitted,

DAIN BOSWORTH INCORPORATED

/s/ JC

John E. Conrad

Senior Vice President

cc: James H.B. Wilson  
Marshall Crawford (Smith Barney-Denver)  
Greg Johnson (Kutak)  
Arlene Bobrow (Sherman & Howard)  
Will Dougl[sic] (Kirchner)

**Jeffers****DEPOSITION EXHIBIT 65****11-29-89****AGREN, BLANDO & ASSOCIATES****(LOGO)****STETSON HILLS**

5455 North Union Blvd.

Colorado Springs, CO 80918

(303) 528-1808

January 27, 1988

Ms. Cheryl Crandall

Corporate Trust Department

Central Bank of Denver

5th Floor

1515 Arapahoe Street

Denver, Colorado 80202

RE: Stetson Hills Public Building Authority: John Conrad Letter of January 25, 1988

Dear Cherry:

I have recently received a copy of John Conrad's letter discrediting the appraisal and our assessment computations. As you are aware, we have undertaken a new summary appraisal for the \$15,000,000 Bond Issue. This appraisal was recently completed and is being Federal Expressed for your review. We shall be adding some additional ground as described in the appraisal which you will be receiving. We are ready to immediately make these additions which shall more than correct any concerns that Mr. Conrad has expressed. We also shall be making the bond reserve payment next week. These items shall more than correct Mr. Conrad's concerns which are

OVERSIZE FOLDOUT(S) FOUND HERE IN  
THE PRINTED EDITION OF THIS VOLUME  
ARE FOUND FOLLOWING THE LAST PAGE  
OF TEXT IN THIS MICROFICHE EDITION.

SEE FOLDOUT NO 1-9

evidently the result of his inability to understand the provisions of this transaction.

Mr. Conrad specifically told me to feel free to use the reserve accounts and also discussed the total status of the Bond Issue approximately 30 days ago; he expressed no concerns to me at this time and furthermore said he was extremely confident in this Bond Issue. Since this time he has been informed that he is not going to be involved with our second Bond Issue. For this reason, I feel he has decided to cast unfounded claims against my credibility and that of our company. I would suggest that we meet next week to discuss these issues after you have had a chance to review the appraisal. The appraisal was prepared using the parcels to be included in both Bond Issues. I would respectfully request that we meet on this issue before any notice of default is mailed based on Mr. Conrad's unfounded claims.

Sincerely,

AMWEST DEVELOPMENT CORPORATION

/s/ Gregory D. Timm/jm  
Gregory D. Timm  
Executive Vice President

GDT:jm

cc: Steve Jeffers, Kirchner  
Will Douglas, Kirchner  
Marshall Crawford, Smith Barney  
John Conrad, Dain Bosworth  
Greg Johnson, Kutak

Jeffers  
DEPOSITION EXHIBIT 72B  
11-30-89 LO  
AGREN, BLANDO & ASSOCIATES

717 Seventeenth Street  
Suite 2700  
Denver, Colorado 80202  
303-292-1600

KIRCHNER MOORE & COMPANY  
A subsidiary of Drexel Burnham Lambert Incorporated  
Investment Bankers

January 28, 1988

Mr. John Conrad  
Senior Vice President  
Dain Bosworth, Inc.  
1225 17th Street, Suite 1800  
Denver, CO 80202

Re: Stetson Hills Public Building Authority

Dear John:

We are in receipt of your January 25, 1988, letter to Cherry Crandall at Central Bank of Denver regarding the above captioned district. Let us begin by saying that as co-managers of the 1986 issue, we share your concern that the Authority and the Trustee continually comply with the Bond covenants, and that the security for the Bonds remain intact as provided for by the Bond documents. We would echo your comments that this is indeed a complicated transaction, and that the 110% Test and the 160% Test are two of the most important covenants within the Bond documents.

It is at this juncture, however, that we differ in our analysis of the "facts" as you represent them. Not only do



we disagree with your numbers, but we may be in disagreement with your thought process as well. First, let me discuss your numbers. Specifically, referring to page 8 of the project analysis, you indicate "... that in order to meet the 110% Test in 1987, either \$3,854,865.00 of assessments should have been paid or land with sufficient value should have been added to the collateral." Your cash flows on page 8 do not support your contentions. If we are analyzing page 8 correctly, the first two columns represent residential assessments and non-residential assessments still outstanding after projected sales for the previous years have occurred. Yearly projected sales are detailed on pages 2 and 3, and pages 6 and 7 specifically identify the value of the collateralized property remaining after these yearly sales. It seems you have erroneously added the first two rows of the column labeled "Total Res. Asmts. Due" on page 8 (which total \$3,858,866.00) and identified this as assessments that should have been paid in 1987. In point of fact, as of December 30, 1987, the figures on page 8 of \$1,547,564 of residential assessments and \$10,742,833 of non-residential assessments were amounts projected to be outstanding and remaining as collateral. The correct analysis of assessments which were projected to be collected during 1987 is shown on page 5, by adding the first two rows of the first column entitled "Assessments Paid In." This amount which equals \$3,681,082. [sic] Had these assessments been paid during 1987, 31.9 acres of single family residential (R-1-6000), 29.5 acres of multi-family residential (PUD), 21.1 acres of non-residential (PIP), and 4.7 acres of non-residential (PBC) would have been released as collateral by the Trustee.

As for our disagreement with your thought process (and assuming your numbers had been correct), you state that had the Trustee not received \$3,854,865.00 from assessments being paid, that land with a sufficient value should have been added as collateral. The insinuation seems to be that a significant amount of additional land would be required to be added in lieu of cash in order to be in compliance with the 110% Test. Even with no land sales occurring, assuming the developer only prepays assessments adequate enough to fund debt service (and receives releases for land based on the assessment amounts prepaid), it is our belief that very little land needs to be added to maintain the 110% Test. In fact, since on the date of Bond closing the 110% Test produced a ratio of 118%, it is our contention based upon cash flows we've run that as of year end, (and assuming the reserve fund were replenished [sic] by the Developer within the allowable 60 days) the 110% Test is met. If you're suggesting any additional land would be required, we disagree with your thinking.

Further, you indicate that pages 2 and 3 of your project analysis require certain assessment rates to be in place. We specifically disagree with your value for multi-family (PUD), and believe the value (according to your project analysis) should be \$32,403 per acre, not \$597,192 per acre. Moreover, we generally disagree with your project analysis in figuring the Interest Component on the unpaid Allocated Assessment Charges (i.e. the columns your project analysis refers to as "Assessment Rate"). The Bond documents call for interest to be figured on a simple interest basis at the highest interest rate borne by the Bonds (i.e. 9.00%). Your analysis uses an interest rate of

9.25%, and compounds the interest component. Although the higher rate and compounding have little effect in the early years of the project analysis, they have a substantial impact in the later years.

A few final comments seem appropriate. We would not argue that the original appraisal is now somewhat stale, and that a current update would be prudent. A new appraisal has in fact been completed, and at this time should be in the hands of the Trustee. Some delay in the preparation of the updated appraisal can be directly attributable to enlarging the scope of the appraisal to encompass the proposed new bond issue. However, since it was always the intent of the Authority to provide yearly updates of the appraisal on a calendar year basis, we do not feel that a 30 day delay is unreasonable. With the new appraisal, the Trustee will be able to verify the 160% Test, and in the event the Authority is not in compliance, additional collateral will be added as evidenced by Greg Timm's January 27, 1988, letter to Cherry Crandall.

You suggest that property was released from the Lien of the Indenture without appropriate amounts being placed in the Bond Fund, accusing the Authority of giving false or misleading certifications to the Trustee. You further suggest, based upon what appears to be both a faulty project analysis as well as a misreading of data within the analysis, that the Authority is not in compliance with the Bond covenants. I believe you have done an injustice to the Authority, the Developer and the Trustee by making these accusations without a more careful review of the facts. Even if you were confident that your facts and numbers were correct, it seems to me a meeting

with the parties involved would have been preferable, prior to written correspondence. Furthermore, it seems advisable to copy the Authority with your correspondence with the Trustee, since in fact it is the Authority you are targeting as being out of compliance with the Bond documents.

We would strongly suggest a meeting be held with you, ourselves, the Trustee, and if necessary, the Authority or Developer at the earliest possible time to review your and our contentions and see if we can rectify the situation without further barrages of letters being sent to interested but not directly involved parties. We will call you tomorrow to try to arrange such a meeting.

Sincerely,

KIRCHNER MOORE &  
COMPANY

/s/ Steven D. Jeffers  
Steven D. Jeffers  
Vice President

/s/ William C. Douglas, Jr.  
William C. Douglas, Jr.  
Vice President

SDJ/WCD:bjk

cc: Greg Timm  
James H.B. Wilson  
Cherry Crandall  
Marshall Crawford  
Greg Johnson  
Arlene Bobrow

**Jeffers**  
**DEPOSITION EXHIBIT**  
**12-1-89**  
**AGREN, BLANDO & ASSOCIATES**

Steven D. Jeffers      717 Seventeenth Street  
 Vice President      Suite 2700  
 Public Finance      Denver, Colorado 80202  
                                  303-292-1600  
                                  KIRCHNER MOORE &  
                                  COMPANY  
                                  A Subsidiary of Drexel Burnham  
                                  Lambert Incorporated  
                                  Investment Bankers

February 10, 1988

Greg Timm  
 Mark Camerand  
 AmWest Development Corporation  
 5455 N. Union Blvd.  
 Colorado Springs, CO 80918

Greg Johnson  
 Steve Pastrana  
 Kutak, Rock & Campbell  
 2400 Arco Tower  
 707 17th Street  
 Denver, CO 80202

Gentlemen:

This letter will summarize the time schedule of events and person(s) responsible for completing the tasks outlined during our meeting last Wednesday night.

Exhibit E

<u>Date</u>	<u>Event</u>	<u>Person Responsible</u>
Early the Week of 2/8	Sales projection information to be distributed to Kutak & Kirchner	Mark Camerand
Week of 2/8	Revised appraisal completed and distributed	Greg Timm
2/10	Meeting with Trustee, Kutak, AmWest, Kirchner to discuss compliance on 1986 Bond issue	All
2/15	1988 Financial Statement of AmWest completed	Greg Timm
Week of 2/15	Cash flows completed	Steve Jeffers
Week of 2/15	Preliminary Official Statements distributed	Kutak
Week of 2/22	Meeting with Jim Wilson, AmWest, Kirchner, Kutak	Steve Jeffers
Week of 2/22	Meeting with Kirchner Moore commitment committee. Meeting with Smith Barney regarding participation in 1988 issue.	Steve Jeffers



Please let me know if any of you find any discrepancy between this schedule and what we discussed at our meetings.

Sincerely,

KIRCHNER MOORE &  
COMPANY

/s/ Steven D. Jeffers  
Steven D. Jeffers

SDJ:bjk

cc: Will Douglas

Jeffers  
DEPOSITION EXHIBIT 69  
11-29-89  
AGREN, BLANDO & ASSOCIATES

(LOGO)  
DAIN  
BOSWORTH  
INCORPORATED  
INTER-REGIONAL FINANCIAL  
GROUP

February 22, 1988

Ms. Cherry Crandall  
Corporate Trust Officer  
Central Bank of Denver  
1515 Arapahoe Street  
Denver, Colorado 80292

Re: Stetson Hills Public Building Authority

Exhibit H

Dear Cherry:

We have reviewed the appraisal, which you so graciously supplied us, and I have made comments relative to the methodology and selection of comparables. These comments are included herein.

I have also computed the tests, based on the appraisal. There are two areas I want to point out. 1) In computing the interest component of the allocated assessment charges, I have computed interest at "simple" from the original bond closing date on all parcels. On the R & D parcel, which is a new parcel, if interest was computed from the date the parcel was added, the 160% test would be higher. However, the 110% test would be lower. Under the documents, when property is substituted the interest component is computed from the original closing date. When property is added, however, the documents are silent and I think it could be presumed that interest begins to accrue when the property is added.

2) The 110% test was designed as an end of period test (i.e. on interest payment date). Consequently, in the 110% test, accrued interest on the outstanding bond principal should be added to the denominator when making the test intra-period.

It is comforting to know that your real estate people are assisting you in evaluating the appraisal. We appreciate your efforts on behalf of the underwriters and the bond holders.

Yours very truly,

DAIN BOSWORTH  
INCORPORATED

/s/ JC  
John Conrad

17TH STREET PLAZA BUILDING/SUITE 1800/1225  
17TH STREET/DENVER, COLORADO 80202-5599

(303) 294-7200

#### STETSON HILLS PUBLIC BUILDING AUTHORITY

Observation of appraisal done for Greg Timm, Am West Development, dated January 4, 1988

#### PBC Zone Land

- \* Cannot believe that appraiser could not find comparable sales more recent than 1985 and 1986 when there were several foreclosure sales in 1987. Using comparables that are tied to a more upbeat market, tends to overstate the current value of the PBC Collateral. Even using the 1985 and 1986 comparables, it is hard to see how Hastings could have arrived at a \$5.00 per square foot current value for the PBC property (see Table 7.1 and 7.2) for Parcel 6033; (Table 7.3 for Parcel 5053);

#### PIP Zone Land

- \* Same comment applies to PIP comparable sales. The most recent comparable sale of 7/9/86 just seems incomprehensible in view of the foreclosure sales in 1987. The PIP value selected for Parcel 6045 is, however, substantially below the comparable values used for the comparison (see Table 8.1 and 8.2).

#### PUD Zoned Land

- \* Most recent comparable is 1/2/87 with the next oldest 5/6/86. These are, in our opinion, just too old to be of any use in this appraisal. Everyone knows that multi-family land is not moving in Colorado Springs (see Table 9.1 and 9.2).

#### R-1-6000 Zone Land

- \* I don't understand why the appraiser did not use sales of residential property in the subject area to Nash Phillips Copus and North American Homes to establish valuation basis. Even though these sales were, on average, \$2-3,000 below the value per lot that Hastings has used, they would lead one to believe that this is more reflective of the value that the bondholder could expect. In the 1986 appraisal, Hastings assigned a value of \$0.80/square foot to Parcel 6043 as partially developed (see Table 12). In the 1988 appraisal, the value increases to \$1.00/square foot. No reason is given for the 25% increase in value and there is no indication as to whether the property is partially or totally developed. In addition, the appraiser seems to value gross acres even through some of the acreage will be dedicated to streets.
- \* Hastings states on page 36 (latest appraisal) that he is in accord with the Absorption Analysis of Research and Consulting Group (Exhibit 10) that is dated May 1987. Dave Bamberger of Research and Consulting Group says that study is dated and may not be reflective of current environment.

It just seems that Hasting is relying on old data and his appraisal may not be reflective of the current environment.

Filing 12-13-14 were made in 1986 and were improved when bonds were issued according the Metex Study (Exhibit 6).

1000  
2000  
3000

## STETSON HILLS PUBLIC BUILDING AUTHORITY

COMPUTED AS OF 3-1-88

1	2	3	4	5	6	7	8	9	10	11	12	13
10% TEST & APPRAISE	VALUE (ALLOCATED)	MOORE HOUT - FUNDING + FUNDING										
	PRINCIPAL	INTEREST										
MOORE	PERCENT	COMPOUND										
6033	310	122114	-	1	92307035	2	92081345					
6091	2842	122114	-	1	37034171	2	369523147					
5033	704	122114	-	1	5513171	2	54840025					
5078	345	122114	-	1	5340353	2	53224170					
6015	4148	74444	-	1	51853403	2	518044154					
REB	1832	74444	00	1	15326812	2	15277192					
6018	1349	27444	-	1	9156329	2	91350027					
5051	2021	17444	-	1	6240215	2	57793360					
FEED (6043)	441	20400	-	1	1586661	2	15486514					
FEED (6043)	160	20400	-	1	3657354	2	36386330					
FEED (6043)	1878	20400	-	1	2742814	2	12707307					
FEED (6043)	777	20400	-	1	1040744	2	1024138					
							17427537.07					
* INTEREST COMPONENT PAID AT 9% ANNUAL INTEREST FROM 3-1-88 TO 3-1-89 (1 YEAR) = 11.78 / 1000												
110% TEST - ALLOCATED RESERVES / Basis Formula - (Reserve Fund + Bond Fund + Debt Fund)												
	17,923.55	01/91,000,000	-	1	1,159,100							
	17,923.55	01/91,000,000	-	1	1,159,100							
RESERVE FUND RESERVE FUND AS OF 3-1-88 1,159,100												
* IF THE DESIGNATOR FOR THE 10% TEST IS 003, THE FUND RESERVE FUND IS 1,159,100												
FUND OF 4,219,276.71, THE 10% TEST IS 1,159,100												

DCU-150



**DEPOSITION EXHIBIT 258**

**1-24-90**

**LO**

**AGREN, BLANDO & ASSOCIATES**

**KUTAK ROCK & CAMPBELL**

**A Partnership**

**Including Professional Corporations**

**2400 ARCO Tower - 707 17th Street**

**Denver, Colorado 80202**

**(303) 297-2400**

**Atlanta**

**New York**

**Omaha**

**Washington**

**February 26, 1988**

**TO: ALL PERSONS ON THE ATTACHED DISTRIBUTION LIST**

**\$10,000,000**

**THE COLORADO SPRINGS-STETSON HILLS**

**PUBLIC BUILDING AUTHORITY**

**Landowner Assessment Lien Bonds**

**Series 1988A**

**Ladies and Gentlemen:**

Enclosed is a form of Preliminary Official Statement for the above-captioned financing. That Official Statement reflects most of the information we have received to date with regard to the Company and the Development.

At various places in the document, there are statements with regard to the status of the Development and the Company which refer to dates which are two or three months old. In many cases, that information is stated to be current as of December of 1987. Prior to mailing the

**Exhibit F**

Preliminary Official Statement for the transaction, the appropriate representative of the Company should review those sections of the Preliminary Official Statement which concern the Company and the Development in order that the information can be updated to a date which is relatively current as of the time of the mailing of the Preliminary Official Statement.

One of the areas which may require further examination is the information in the Official Statement concerning lot sales. The figures we have received from the Company indicate that the Company has closed approximately 383 residential lots within the Development, and that an additional 380 lots are under contract for sales for home builders. The lot sales contracts which we have received to date from the Company indicate as follows: (a) 134 lots were required to be purchased by North American Homes from the Company pursuant to two separate lot purchase contracts, 66 of which were required to be purchased by September 1, 1987 and 68 of which were required to be purchased by March 1, 1988; (b) 29 residential lots were required to be purchased by Richmond Homes prior to February 10, 1988, pursuant to a contract dated July 10, 1987; (c) 109 lots were required to be purchased from Nash Phillips Copus pursuant to a contract dated October 22, 1986; and (d) approximately 101 lots were required to be purchased by Coventry pursuant to a contract dated July 14, 1986, as subsequently amended on September 12, 1986 and November 17, 1986.

The total lot sales contemplated by the contracts described above are 373, which amount is considerably less than the lot sales figures which appear in the Official

Statement. We understand from Greg Timm that Coventry is currently in default in its contract with the Company and has purchased less than all of the 101 lots contemplated by its contract. Given the bankruptcy of Nash Phillips Copus, we presume that less than the 109 single family lots required to be purchased by Nash Phillips Copus have, in fact, been bought.

The foregoing figures concerning lot sales lead us to believe that there are additional contracts for the sale of residential lots which have not been provided. In order to complete our due diligence on the Official Statement, we ask that copies of the additional lot purchase contracts be provided to us at the earliest convenience.

We look forward to receiving your comments and suggestions concerning the enclosed document. Additional changes are likely to be made in the document upon receipt of the audit report for the Company and final information concerning the property to be encumbered under the 1986 and 1988 Bond issues, as well as the appraisals for those properties.

Yours sincerely,

/s/ Gregory V. Johnson  
Gregory V. Johnson

kjp

Enclosure

\$10,000,000

THE COLORADO SPRINGS-STETSON HILLS  
PUBLIC BUILDING AUTHORITY  
Landowner Assessment Lien Bonds  
Series 1988A

---

DISTRIBUTION LIST

Gregory D. Timm, Esq.  
Mr. Marc A. Camirand  
Stetson Hills  
By AmWest Development Corporation  
5455 North Union Boulevard  
Colorado Springs, CO 80918

Mr. Steven D. Jeffers  
Mr. William C. Douglas, Jr.  
Kirchner Moore & Company  
Suite 2700  
717 17th Street  
Denver, Colorado 80202

Ms. Cheryl A. Crandall  
Central Bank of Denver  
Tower 3, 5th Floor  
1515 Arapahoe Street  
Denver, CO 80202

Mark E. Winslow, Esq.  
Sparks, Dix, Enoch, Suthers & Winslow, P.C.  
128 South Tejon  
Post Office Box 1678  
Colorado Springs, CO 80903

Gregory V. Johnson, Esq.  
R. Steven Pastrana, Esq.  
Kutak Rock & Campbell  
2400 ARCO Tower  
707 17th Street  
Denver, CO 80202

Stetson Hills Value Comparison

<u>Parcel</u>	<u>1986 Appraised Time Discounted Value In Original Appraisal</u>	<u>1988 Appraised Time Discounted Value In Current Appraisal</u>
6045	8,100,000	6,593,846
6033	6,752,000	6,752,000
5098	860,000	860,000
5053	880,000	880,000
6041	5,922,000	5,922,000
6047	1,813,000	1,436,033
6044	229,000	206,157 *
6043	1,703,000	1,206,794 *
6048	601,000	584,588
5051	1,016,000	785,400
Total Value of Collateral	<u>27,876,000</u>	<u>25,226,818</u>
Debt Principal Outstanding	<u>15,000,000</u>	<u>15,000,000</u>
Ratio: Value to Debt	1.86x	1.68x

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\* Not separately appraised - based upon per acre value from appraisal as of Jan. 4, 1988 for R-1-6000 zoning and removes 24 acres valued at \$29,660/acre previously released in July 1987.

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Jeffers  
 DEPOSITION EXHIBIT 72  
 11-29-89 LD  
 AGREN, BLANDO & ASSOCIATES

(LOGO) Central Bank  
 Denver

March 22, 1988

Greg Timm  
 Stetson Hills  
 5455 N. Union Boulevard  
 Colorado Springs, CO 80918

RE: Stetson Hills PBA Landowner Assessment  
 Lien Bonds Series 1986A  
 Account Number 80-5021

Dear Gregg:

We have completed our review of the Appraisal dated January 4, 1988, prepared by Joseph L. Hastings. As you know, we have also had the appraisal reviewed by Ed Elmer of our lending area, who we consider to be our resident expert on the subject of real estate appraisal. In connection with Mr. Elmer's review, he has spoken directly with Mr. Hastings by telephone regarding certain issues.

Based upon our review, and the recommendation given us by Mr. Elmer, we will require, in our capacity as Trustee, that an independent review of the appraisal be conducted by a different appraiser, which may be selected subject to our approval. It is our preference that Zaleski & Associates be engaged if possible for this purpose.

We are requiring that an independent review of the appraisal be conducted for the following reasons:

1. The age of the comparable sales data makes it of questionable use as a valid basis for valuation. We question why more recent sales were not utilized for this purpose.
2. Mr. Hastings has confirmed that his discounting methods did not consider a bulk sale in a forced liquidation context, as is specifically required by the Indenture.
3. Based on our review and investigation, the values determined by the appraisal appear to be unjustifiably optimistic, given the current economic conditions in the residential and commercial real estate markets in El Paso County.

Please let me know if you have any further questions regarding this matter.

Cordially,

/s/ Cherry Crandall  
 CHERYL A. CRANDALL  
 Corporate Trust Officer

cc: Gregory V. Johnson, Kutak Rock & Campbell  
 John Conrad, Dain Bosworth  
 Steven D. Jeffers, Kirchner Moore

jj  
 1515 Arapahoe Street/Denver, Colorado 80292/  
 (303) 893-3456

Jeffers  
DEPOSITION EXHIBIT 74  
11-29-89 LO  
AGREN, BLANDO & ASSOCIATES

Stetson Hills - Greg Timm March 31

Ken Buckius, Steve

- 1) Chain of Events. -
- 2) Now in compliance - supposedly in position of needing new appraisal - spent \$14,000 on appraisals

Greg's offer: will use Jerry Zaleski instead of Hastings at the end of the year upon Cervasis request

Our position is that the methodology is in compliance w/requirements of legal documents

-need letters from Hastings

-need to adjust the ratios

1986 issue

- 1) bring \$2M new land in
- 2) recalculate assessments
- 3) get certifications from Gary Johnson & Powers
- 4) get contract letter from Central
- 5) go to city

- Need to get Ken to go to Trust Committee to buy off on Greg's offer then have him give summary of time required for [sic] to Ken & Greg on Tuesday.

Jeffers  
DEPOSITION EXHIBIT 74A  
11-30-89 LO  
AGREN, BLANDO & ASSOCIATES

3/31/88

Stetson Hills -

Greg Timm, Will Douglas, Steve Jeffers & KB

- GT - willing to put up additional ground; \$2 million - doesn't want to do new appraisal & willing to ask - Zaleski to do appraisal at end of the calendar year. - did take into consideration bulk sales - w/Hastings appraisal

- a) Jeffers believes that bulk sales were treated w/in methodology of the bulk sales.

Comparables → many recent sales have been lender foreclosures & Hastings did consider the end of year sales to make sure they are in conformance.

\* - draft letter to see if Hastings can live w/it.

Call Steve Wednesday.

Cert of KRC (& their attys.) & RMConnections.

Ratios by CPA on new deal

Verification that considered reasonableness of app.

Dec. 10, 1988 → before 12/1 preferable

Committee dec: → Dec. review of the situation.

6 to OK compromise

Exhibit L

Jeffers  
 DEPOSITION EXHIBIT 75  
 11-29-89  
 AGREN, BLANDO & ASSOCIATES

(LOGO) Central Bank  
 Denver

April 8, 1988

RE: Stetson Hills PBA Landowner Assessment Lien  
 Bonds  
 Series 1986A  
 Account No. 80-5021

Dear Greg:

Our corporate trust committee has reviewed the proposal you presented to Steve Jeffers, Will Douglas and myself on March 31, 1988 which proposal was in response to our letter of March 22, 1988 concerning the Hastings appraisal.

Our understanding of the details of the proposal is as follows:

1. The current Hastings appraisal will be used but it will be supplemented by a letter from Mr. Hastings which pertains to our concerns upon review of the appraisal relating to non-use of recent comparables and the bulk sale in a forced liquidation discounting methodology utilized.
2. That a new appraisal will be provided to us by December 10, 1988 and be performed by Zaleski & Associates.
3. Additional property will be subjected to the Assessment Lien. The additional property has an approximate value of \$2 million. This will be done in order to allow the Allocated Assessment Charge to be reduced

and bring the 110% Test and 160% Test into compliance.

4. All provisions of Section 5.3 of the Public Improvements Assessment and Lien would need to be satisfied including the title insurance requirement.
5. Certificate of the Company's attorney relating to the calculation of the 110% and 160% Tests.

It should be noted that copies of all documents presented to the Trustee by a Property Owner must be provided to the Original Purchasers under Section 7.1 of the Public Improvements Assessment and Lien.

The committee believes that the proposal is reasonable and would find that the requirements of the bonds have been complied with upon our receipt and satisfaction of the above detailed items in the near future with the exception of Item No. 2. This position is taken with the expectation that a new appraisal by Zaleski and Associates will be delivered in December without waiver or delay.

It should also be recognized that it is likely that we will be requiring annual updates of the appraisal on these types of bond transactions to meet the concerns of the Trust Committee. In addition, when certifications by the Company are made concerning the various Tests, we would request that they be reviewed by their attorneys.



If you would like to discuss these matters or have any questions, please call me.

Very truly yours,

/s/ Ken  
KENNETH B. BUCKIUS  
Vice President

ds

Enclosures

cc: ✓Steve Jeffers     Kirchner Moore & Company  
717 17th Street  
Suite 2700  
Denver, CO 80202

Greg Johnson     Kutak Rock & Campbell  
2400 Arco Tower  
707 17th Street  
Denver, CO 80202

1515 Arapahoe Street/Denver, Colorado 80292/  
(303) 893-3456

#### DRAFT CERTIFICATE

This certificate is rendered on behalf of Joseph L. Hastings Company (the "Appraiser") in connection with the issuance of an appraisal report dated \_\_, 1988 (the "Appraisal") of selected parcels of property from the Stetson Hills Master Plan located Northeasterly of Powers Boulevard and Barnes Road in the City of Colorado Springs, Colorado. The Appraisal has been issued by the Appraiser for the benefit of Amwest Development I, Limited Partnership (the "Company"). The Company participated in the issuance of \$15,000,000 in aggregate

principal amount of Landowner Assessment Lien Bonds, Series 1986A issued by The Colorado Springs - Stetson Hills Public Building Authority (the Authority") pursuant to the Indenture of Trust dated December 1, 1986 (the "Indenture") between the Authority and Central Bank of Denver, as trustee (the "Trustee").

In connection with the preparation of the Appraisal, the undersigned Appraiser hereby certifies for the benefit of the Trustee as follows:

1. The Appraiser is a "Qualified Appraiser" within the meaning of such term as used in the Indenture.
2. The Appraisal constitutes a "Qualified Appraisal Report" within the meaning of such term as used in the Indenture.
3. The definition of market value for each of the properties described in the Appraisal is the same as the "As Is Value" for such property within the meaning of such term as used in the Indenture.
4. The method of calculating the bulk sale discount as set forth in the Appraisal produces a bulk sale discount which is the same as the calculation required by the Indenture for the Bulk Sale Discount.
5. The comparable sales in 1987 were not used in the appraisal because they would not have materially effected the conclusions of value of the Appraisal.

IN WITNESS WHEREOF, the undersigned has executed this certificate on behalf of Joseph L. Hastings Company as of this \_\_ day of \_\_, 1988.

JOSEPH L. HASTINGS  
COMPANY

May 13, 1988

Central Bank of Denver  
Tower 3, 5th Floor  
1515 Arapahoe Street  
Denver, CO 80202

Attention: Corporate Trust Department

\$11,000,000

THE COLORADO SPRINGS-STETSON HILLS  
PUBLIC BUILDING AUTHORITY  
Landowner Assessment Lien Bonds  
Series 1988A

---

Ladies and Gentlemen:

This agreement is provided on behalf of The Colorado Springs-Stetson Hills Public Building Authority (the "Authority") and AmWest Development I Limited Partnership (the "Company").

The Authority has previously issued its Landowner Assessment Lien Bonds, Series 1986A, in the aggregate principal amount of \$15,000,000 (the "Series 1986A Bonds"), and is in the process of issuing its Landowner Assessment Lien Bonds, Series 1988A, in the aggregate principal amount of \$11,000,000 (the "Series 1988A Bonds").

The purpose of this agreement is to set forth the understanding among the Authority, the Company and Central Bank of Denver, as trustee for the Series 1986A Bonds and the Series 1988A Bonds (the "Trustee"). On or prior to the issuance of the Series 1988A Bonds, the Company and the Authority will provide the Trustee the following information:

1. Information satisfactory to the Trustee establishing the nature of the public improvements to be financed with the proceeds of the Series 1988A Bonds, including, if requested by the Trustee, information concerning the types of public improvements, their location and the relationship to the improvements financed with the proceeds of the Series 1986A Bonds.

2. The Company will engage a qualified appraiser as provided in the definition of "Qualified Appraiser" in the Indenture of Trust dated as of December 1, 1986, by the Authority and the Trustee as shall be acceptable to the Trustee, to provide appraisals on an annual basis for the land which is encumbered for the benefit of the Series 1986A Bonds and the Series 1988A Bonds and be completed within 90 days, and shall continue not less often than annually thereafter so long as any Series 1986A Bonds or Series 1988A Bonds shall remain outstanding, unless the Trustee shall determine that such an appraisal is unnecessary in a given year or years. Zaleski and Company, if willing and able to provide such appraisal, will be included among the list of Qualified Appraisers submitted by the Company to the Trustee.

Very Truly yours,

THE COLORADO SPRINGS-STETSON  
HILLS-PUBLIC AUTHORITY

By: /s/ Gregory D. Timm  
Name: Gregory D. Timm  
Title: Secretary

AMWEST DEVELOPMENT I LIMITED  
PARTNERSHIP

By: /s/ Gregory D. Timm

Name: Gregory D. Timm  
 Title: President of General  
Partner  
AmWest Development  
Corporation.

Accepted as of the date set forth above by the Central Bank and Trust Company of Denver, d/b/a/ Central Bank of Denver, a Banking Corporation, as trustee.

By: /s/ Kenneth B. Buckius  
 Name: Kenneth B. Buckius  
 Title: VP

#### NEW ISSUE

Kutak Rock & Campbell, Bond Counsel, is of the opinion that, assuming continuing compliance with certain requirements described herein, under the laws, regulations, rulings and judicial decisions existing on the date of the original delivery of the Series 1988A Bonds, interest on the Series 1988A Bonds is not includible in gross income of a registered owner thereof for purposes of federal or State of Colorado income taxation. See "TAX EXEMPTIONS."

\$11,000,000

#### THE COLORADO SPRINGS-STETSON HILLS PUBLIC BUILDING AUTHORITY

Landowner Assessment Lien Bonds, Series 1988A

Dated: May 15, 1988 Due: May 15, as shown below

The Colorado Springs-Stetson Hills Public Building Authority, Landowner Assessment Lien Bonds, Series 1988A (the "Series 1988A Bonds"), will be issued as fully

registered bonds without coupons in the denomination of \$5,000 or any integral multiple thereof. Principal will be payable upon surrender of the Series 1988A Bonds at the Central Bank and Trust Company of Denver (doing business as Central Bank of Denver, A Banking Corporation), in Denver, Colorado, as trustee (the "Trustee"). Interest on the Series 1988A Bonds is payable on May 15 and November 15 of each year, commencing November 15, 1988, by check or draft mailed by the Trustee to the registered owners of the Series 1988A Bonds. See "THE SERIES 1988A BONDS."

#### MATURITIES, AMOUNTS, RATES AND PRICES

Due	Amount	Interest	Due	Amount	Interest
May 15	Maturing	Rate	May 15	Maturing	Rate
1990	\$250,000	6.50%	1995	\$360,000	8.20%
1991	265,000	7.00	1996	390,000	8.40
1992	285,000	7.50	1997	425,000	8.60
1993	310,000	7.75	1998	460,000	8.80
1994	330,000	8.00	1999	505,000	9.00

\$2,555,000 9.20% Term Bonds due May 15, 2003

\$4,865,000 Term Bonds due May 15, 2008, N.R.O.

Price of all Series 1988A Bonds Offered: 100%

(Plus accrued interest from May 15, 1988)

The Series 1988A Bonds are subject to mandatory redemption (including mandatory sinking fund redemption) as set forth in this Official Statement. In addition, the Series 1988A Bonds (other than the Series 1988A Bonds maturing on May 15, 2008) are subject to optional prior redemption, without premium on or after May 15, 1996, as set forth in this Official Statement. The Series 1988A Bonds maturing on May 15, 2008 are subject to optional redemption on or after May 15, 1998, with a



premium in certain years. See "THE SERIES 1988A BONDS - Redemption Provisions."

The Series 1988A Bonds do not constitute a debt or indebtedness of The Colorado Springs-Stetson Hills Public Building Authority (the "Authority"), the City of Colorado Springs, Colorado (the "City"), or any other political subdivision within the meaning of any constitutional, charter or statutory provision or limitation; are not general obligations of the Authority or any other political subdivision; and are payable and collectible solely out of the Allocated Assessment Charges imposed on approximately 272 acres of land in the City, amounts on deposit in a Reserve Fund initially funded with the proceeds of the Series 1988A Bonds and certain other amounts pledged under the Indenture referred to herein. See "SECURITY FOR THE SERIES 1988A BONDS." The registered owner of any Series 1988A Bond may not look to any general or other fund of the City for the payment of principal or interest on the Series 1988A Bonds. See "SECURITY FOR THE SERIES 1988A BONDS" and "THE INDENTURE - Flow of Funds."

The Authority has previously issued, sold and delivered its Landowner Assessment Lien Bonds, Series 1986A, in the aggregate principal amount of \$15,000,000 pursuant to an Indenture of Trust (the "1986A Indenture") and certain financing documents (the "1986A Bond Documents"), all dated as of December 1, 1986 to finance certain public undertakings within the Stetson Hills Master Plan Area boundaries. The trust estate pledged under the 1986A Indenture does not constitute, in any manner, security for the 1988A Bonds, and the Indenture under which the Series 1988A Bonds are being issued does not

constitute, in any manner, security for the Series 1986A Bonds. No Event of Default under the 1986A Bond documents shall constitute an Event of Default under the 1988A Bond Documents, and no Event of Default under the 1988A Bond Documents shall constitute an Event of Default under the 1986A Bond Documents. See "SECURITY FOR THE SERIES 1988A BONDS."

*Each prospective investor should read this entire Official Statement and should give particular attention to the section entitled "RISK FACTORS."*

The Series 1988A Bonds are offered when, as and if issued by the Underwriters named below and subject to prior sale, or withdrawal of such offer without notice. The offer of the Series 1988A Bonds is subject also to the delivery of an approving opinion by Kutak Rock & Campbell, as Bond Counsel, and other conditions referred to herein. See "LEGAL MATTERS." It is expected that the Series 1988A Bonds will be available for delivery in Denver, Colorado on or about June 16, 1988, against payment therefor.

KIRCHNER MOORE & COMPANY

HANIFEN, IMHOFF INC.

A subsidiary of Drexel Burnham Lambert Incorporated

The date of this Official Statement is May 20, 1988

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payment of the Series 1988A Bonds. To the extent that other Property Owners become obligated for the payment or prepayment of Allocated Assessment Charges, their

financial condition and operations may also affect payment of the Series 1988A Bonds. In addition, another entity involved in a merger, consolidation or other transaction involving acquisition of substantially all of the Company's assets may assume the Company's obligations under certain circumstances. See "THE DEVELOPMENT AGREEMENT - Covenants of the Company."

Under the documents relating to the Series 1988A Bonds, the Company is restricted from making distributions of earnings, profits, land or other assets to its partners as long as the Bonds remain outstanding. However, the Company may make return-of-capital distributions provided certain conditions are met. See "GLOSSARY" and "THE DEVELOPMENT AGREEMENT - Covenants of the Company." Distributions of cash or other assets beyond these amounts could adversely affect the Company's financial condition and ability to make later payments or prepayments of Allocated Assessment Charges and increase the Bondholders' risk.

#### Enforcement of Collection Remedies

In the event any Allocated Assessment Charges are delinquent, the Trustee is authorized to enforce the Assessment Lien on all or any part of the Property through the institution of foreclosure proceedings pursuant to court action. Subsequent to the entry of an order of foreclosure by a court, the Trustee may obtain a sale of a particular parcel or parcels of the Property to recover the amount delinquent, as well as the costs of foreclosure

proceedings. Because the Assessment Lien would be foreclosed through judicial rather than administrative procedures, delays in foreclosure of the Assessment Lien should be anticipated, and such delays may be substantial. See "THE ASSESSMENT AND LIEN AGREEMENT - Methods of Foreclosure."

The security provided by the Assessment Lien will depend on the value of the Property that may be realized if a foreclosure of the Assessment Lien were necessary. The Company is required to furnish the Trustee at least annually with a Qualified Appraisal Report of the Property remaining subject to the Assessment Lien and to maintain land subject to the Assessment Lien with an Appraised Value (with adjustments for deposits in the Bond Fund and Reserve Fund as described herein) of at least 160% of the amount of Allocated Assessment Charges then outstanding, all as more fully described herein. It is likely that the Company will be required to subject additional land to the Assessment Lien from time to time to satisfy this continuing obligation to meet the 160% Test. In addition, the Company and other Property Owners are not permitted to substitute land encumbered by the Assessment Lien unless the 160% Test will be met taking the substitution into account. See "THE ASSESSMENT AND LIEN AGREEMENT - Releases or Substitutions of the Property." Similarly, the Authority may not issue Additional Bonds under the Indenture unless the 160% Test will be met taking the Additional Bonds into account. However, despite imposition of these appraised value restrictions, foreclosure is a time-consuming remedy, and foreclosure sales may generate proceeds less than appraised values. See "SECURITY FOR THE SERIES



1988A BONDS -- Allocated Assessment Charges and Assessment Lien." According to the El Paso County Public Trustee's office, during 1987 there was a significant increase in the

\* \* \*

Lien Agreement, the Authority, the Trustee and the property owners shall amend the Assessment and Lien Agreement to reflect a schedule of Allocated Assessment Charges with respect to each parcel of property employing the new zoning or land use designation adopted by the City. The amendment to the Assessment and Lien Agreement as provided in the preceding sentence will not be effective unless the Trustee receives satisfactory evidence that the 110% Test and the 160% Test will be met subsequent to the change, and that such modification will not, in the opinion of nationally recognized bond counsel, cause interest on the Bonds to be includable in gross income for federal income tax purposes.

#### Releases or Substitutions of the Property

Notwithstanding any provision of the Assessment and Lien Agreement, the Trustee will (1) at any time no event of default exists under the Assessment and Lien Agreement, the Development Agreement or the Indenture, upon the written request of the Property Owner, or (2) if an event of default exists, upon the request of an Approving Governmental Body, execute a release with respect to the Assessment and Lien Agreement and any and all other documents, instruments and conveyances as necessary or appropriate to release from the Assessment Lien all or any portion of the Property to be conveyed to

an Approving Governmental Body or other person (other than an Approving Governmental Body) upon payment and receipt by the Trustee of the Allocated Assessment Charges with respect to such parcel of the Property. In addition, the Trustee may release any acreage as to which payment of the applicable Allocated Assessment Charges are made, as long as the Trustee is provided, among other things, satisfactory evidence that after the release the 110% Test and the 160% Test will continue to be met.

Releases of Property also will be permitted if other property is substituted as specified in the Assessment and Lien Agreement. Substitution of Property to be subject to the Assessment Lien will be permitted if all of the following conditions are satisfied:

(a) A good and sufficient first Assessment Lien is conveyed to the Trustee on property located within the Stetson Hills Master Plan Area that previously was not subject to the Assessment Lien;

(b) The Property Owners provide the Trustee with a title insurance policy, in an amount not less than the Principal Component of the unpaid Allocated Assessment Charges on the portion of Property to be released upon substitution, insuring that the Assessment Lien on the property referred to in (a) above, constitutes a first lien subject only to Permitted Encumbrances; and

(c) The Trustee receives satisfactory evidence that both the 110% Test and the 160% Test will be met after giving effect to the substitution.



### Optional Prepayment of Allocated Assessment Charges

Each Property Owner may prepay all or any portion of the unpaid balance of the Allocated Assessment Charges against any portion of the Property at any time and without penalty other than any applicable Premium Component. All prepayments will be paid over to the Trustee for application in accordance with the Indenture. In the event that Allocated Assessment Charges are prepaid by the Property Owners, the prepayment will reduce the Allocated Assessment Charges with respect to the land designated, to the extent of such prepayments. Any partial prepayment of the Allocated Assessment Charges will be applied first to the Interest Component, with any balance to be applied to the Principal Component and Premium Component, if any, of the applicable Allocated Assessment Charges.

### Covenants of Company

The Stetson Hills Master Plan and the zoning designation of the Property are subject to modification or amendment at the request of the Company and upon the approval of the City. The Company covenants in the Assessment and Lien Agreement not to request any change in the Stetson Hills Master Plan or the zoning designation of the property which will substantially and adversely affect the security for the payment of the bonds or which would violate any provision of the Assessment and Lien Agreement or the Development Agreement or which would cause any certification of the Company to the Trustee to be or become untrue in any respect. The

Company will provide written notice to the Trustee within 10 days after any request for a change, modification or amendment to the Stetson Hills Master Plan or the zoning designation of the Property.

As long as the Bonds are outstanding, the Company agrees that the following tests will continuously be met:

- (a) the 110% Test;
- (b) the Principal Component of the unpaid Allocated Assessment Charges will bear interest at the Assessment Interest Rate or the Penalty Rate, as applicable, until paid in full; and
- (c) the 160% Test.

The Company agrees to amend the Assessment and Lien Agreement to increase the Allocated Assessment Charges or to subject additional land within the Stetson Hills Master Plan Area to the Assessment Lien as necessary to comply with the requirements described above.

On or before December 31 of each year, the Company is to provide the following to the Trustee: (i) a certificate to the effect that the Company is in compliance with all of its obligations under the Development Agreement and

\* \* \*

"160% Test" means the test to be applied in certain circumstances under the Indenture, the Development Agreement and the Assessment and Lien Agreement under which the formula

$$\frac{AV}{AAC-(RF + BF)}$$

is required to yield a result not less than 1.6, where "AV" is the Appraised Value of the Property then subject to the Assessment Lien as set forth in a Qualified Appraisal Report addressed to the Trustee and the Original Purchaser, "AAC" is the total unpaid Principal Component plus the total unpaid Interest Component of the Allocated Assessment Charges then unpaid and outstanding (plus the total Principal Component of the Allocated Assessment charges to be levied in connection with the issuance of any Additional Bonds), "RF" is the amount then on deposit in the Reserve Fund, and "BF" is the amount then on deposit in the Bond Fund.

"Original Purchaser" means (a) with respect to the Series 1988A Bonds, Kirchner Moore & Company and Hanifen, Imhoff Inc., and their successors, and (b) with respect to each series of Additional Bonds, such purchaser or purchasers as the Authority shall designate in writing to the Trustee, and their successors.

"Penalty Rate" means 20% per year or a lower rate that at the time is the maximum lawful interest rate under the laws of the State of Colorado and any applicable federal law.

"Permitted Encumbrances" means, as of any particular time, (i) liens for taxes and assessments not then delinquent, (ii) the Assessment and Lien Agreement, the Indenture, the Development Agreement and any financing statements naming the Authority of the Property Owners as debtor and naming the Trustee or the Authority as secured party filed to protect security interests

granted by the Assessment and Lien Agreement, the Indenture and the Development Agreement, (iii) utility access and other easements and rights of way, restrictions and exceptions which, in the opinion of Independent Counsel, will not interfere with or impair the Property, (iv) such minor defects, irregularities, encumbrances and clouds on title as normally exist with respect to property similar in character to the Property and as do not, in the opinion of Independent Counsel, materially impair the value of the property affected thereby or the security for the Bonds, (v) any lien or encumbrance for the purpose of developing or improving property within the Stetson Hills Master Plan Areas and having a priority junior to the Assessment Lien, as set forth in an opinion of Independent Counsel or a title insurance policy acceptable to the Trustee, and (vi) those liens and encumbrances specified in the Assessment and Lien Agreement.

"Premium Component" means the portion of the Allocated Assessment Charges which are designated and paid as a premium with respect to the Principal Component if the Series 1988A Bonds become subject to mandatory redemption

\* \* \*

**Buckius**  
**DEPOSITION EXHIBIT 219**  
**1-17-90**  
**AGREN, BLANDO & ASSOCIATES**

THE COLORADO SPRINGS-  
 STETSON HILLS PUBLIC BUILDING AUTHORITY,  
 A Nonprofit Corporation Organized Under the  
 Laws of the State of Colorado,

AND

THE CENTRAL BANK AND TRUST COMPANY OF  
 DENVER, D/B/A CENTRAL BANK OF DENVER,  
 A BANKING CORPORATION  
 as trustee

INDENTURE OF TRUST

Dated as of May 15, 1988

\* \* \*

ARTICLE II  
 THE BONDS

\* \* \*

Section 2.04. *Authentication.* No Bond shall be valid or obligatory for any purpose or entitled to any security or benefit under this Indenture unless and until a certificate of authentication on such Bond substantially in the form set forth on Exhibit A attached hereto shall have been duly executed by the Trustee, and such executed certificate of the Trustee upon any such Bond shall be conclusive evidence that such Bond has been authenticated and

delivered under this Indenture. The certificate of authentication of the Trustee on any Bond shall be deemed to have been executed by the Trustee if signed by an authorized representative of the Trustee, but it shall not be necessary that the same representative of the Trustee execute the certificate of authentication on all of the Bonds.

\* \* \*

Section 2.06. *Delivery of Series 1988A Bonds.* Upon the execution and delivery of this Indenture, the Authority shall execute and deliver the Series 1988A Bonds to the Trustee and the Trustee shall authenticate the Series 1988A Bonds and deliver them to the Original Purchaser thereof as directed by the Authority as hereinafter in this Section provided.

Prior to the delivery by the Trustee of the Series 1988A Bonds there shall be filed with the Trustee:

(a) a copy, duly certified by the Secretary of the Authority, of a resolution adopted by the Authority authorizing the issuance of the Series 1988A Bonds and the execution and delivery by the Authority of this Indenture, the Development Agreement and the Public Improvements Assessment and Lien;

(b) original executed counterparts of the Development Agreement and the Public Improvements Assessment and Lien;

(c) original executed counterparts of this Indenture;

(d) a copy, duly certified by the Clerk of the City, of a resolution adopted by the City approving the issuance of the Series 1988A



Bonds and the execution and delivery by the Authority of this Indenture, the Development Agreement and the Public Improvements Assessment and Lien;

(e) a title insurance policy, in form and substance satisfactory to the Trustee and the Original Purchaser, insuring the first mortgage interest of the Trustee on the Property pursuant to the Public Improvements Assessment and Lien and this Indenture, subject to no encumbrances other than Permitted Encumbrances, in an amount not less than the Lien Amount;

(f) evidence satisfactory to the Trustee that the 110% Test and the 160% Test shall be met upon the issuance of the Series 1988A Bonds; and

(g) a request and authorization to the Trustee on behalf of the Authority and signed by its President to authenticate and deliver the Series 1988A Bonds to the Original Purchaser upon payment to the Trustee, but for the account of the Authority, of a sum specified in such request and authorization plus accrued interest thereon to the Bond Delivery Date. The proceeds of such payment shall be paid over to the Trustee and deposited in the Bond Fund, the Reserve Fund, the Cost of Issuance Account and the Construction Fund as provided in Section 5.03 of this Indenture.

\* \* \*

## ARTICLE IX THE TRUSTEE

Section 9.01. *Acceptance of Trusts.* The Trustee hereby accepts the trusts imposed upon it by this Indenture, and agrees to perform said trusts, but only upon and subject to the following express terms and conditions:

(a) The Trustee, prior to the occurrence of an Event of Default and after the curing of all Events of Default which may have occurred, undertakes to perform such duties and only such duties as are specifically set forth in this Indenture. In case an Event of Default has occurred (which has not been cured or waived), the Trustee shall exercise such of the rights and powers vested in it by this Indenture, and use the same degree of care and skill in the exercise of such rights and powers as an ordinary, prudent man would exercise or use under the circumstances in the conduct of his own affairs; provided, however, that the Trustee shall be entitled to reasonable reliance upon an opinion of counsel as set forth in subsection (b) below.

(b) The Trustee may execute any of the trusts or powers hereof and perform any of its duties by or through attorneys, agents, receivers or employees, but shall be answerable for the conduct of the same in accordance with the standard specified above, and shall be entitled to reasonably rely upon the advice of counsel to the Trustee concerning all matters of trust hereof and the duties hereunder, and may in all cases pay such reasonable compensation to all such attorneys, agents, receivers and employees as may reasonably be employed in connection with the trusts hereof. The Trustee may act upon the

opinion or advice of any attorney (who may be the attorney or attorneys for the Authority or the Company) approved by the Trustee in the exercise of reasonable care. The Trustee shall not be responsible for any loss or damage resulting from any action or inaction in good faith in reliance upon such opinion or advice.

(c) The Trustee shall not be responsible for any recital herein or in the Bonds (except with respect to the certificate of the Trustee endorsed on the Bonds), or for the recording or re-recording, filing or re-filing of this Indenture, or for the validity of the execution by Authority of this Indenture, or any supplements hereto or instruments of further assurance, or for the sufficiency of the security for the Bonds issued hereunder or intended to be secured hereby.

(d) The Trustee shall not be accountable for the use of any Bonds authenticated or delivered hereunder. The Trustee may become the owner of Bonds secured hereby with the same rights which it would have if not the Trustee.

(e) The Trustee shall be protected in acting upon any notice, request, consent, certificate, order, affidavit, letter, telegram or other paper or document believed to be genuine and correct and to have been signed or sent by the proper Person or Persons. Any action taken by the Trustee pursuant to this Indenture upon the request or authority or consent of any Person who at the time of making such request or giving such authority or consent is the owner of any Bond shall be conclusive and binding upon all future owners of the same Bond and upon Bonds issued in exchange therefor or in place thereof.

(f) As to the existence or nonexistence of any fact or as to the sufficiency of validity of any instrument, paper or proceeding, the Trustee shall be entitled to rely upon a certificate signed by the Authority Representative or the Company Representative as sufficient evidence of the facts therein contained and prior to the occurrence of a Default of which the Trustee has been notified as provided in Section 9.01(h) hereof, or of which by Section 9.01(h) it is deemed to have notice, shall also be at liberty to accept a similar certificate to the effect that any particular dealing, transaction or action is necessary or expedient, but may at its discretion secure such further evidence deemed by it to be necessary or advisable, but shall in no case be bound to secure the same. The Trustee may accept a certificate of such officials of the Authority who executed the Bonds (or their successors in office) under the seal of the Authority to the effect that a resolution in the form therein set forth has been adopted by the Authority as conclusive evidence that such resolution has been duly adopted and is in full force and effect.

(g) The permissive right of the Trustee to do things enumerated in this Indenture shall not be construed as a duty, and the Trustee shall not be answerable for other than its negligence or willful default.

(h) The Trustee shall not be required to take notice or be deemed to have notice of any Default hereunder except (i) failure by the Authority to cause to be made any of the payments to the Trustee required to be made by Article IV hereof and (ii) failure by the Authority or the Company to file with the Trustee any



document required by this Indenture or the Development Agreement or the Public Improvements Assessment and Lien to be so filed subsequent to the issuance of the Bonds, unless the Trustee shall be specifically notified in writing of such Default by the Authority or by the owners of at least twenty-five percent (25%) in aggregate principal amount of Outstanding Bonds, and all notices or other instruments required by this Indenture to be delivered to the Trustee, must, in order to be effective, be delivered at the principal corporate trust office of the Trustee, and in the absence of such notice so delivered the Trustee may conclusively assume there is no Default except as aforesaid.

(i) At any and all reasonable times the Trustee, and its duly authorized agents, attorneys, experts, engineers, accountants and representatives, shall have the right fully to inspect any and all of the property herein conveyed, including all books and records of the Authority pertaining to the collection of Allocated Assessment Charges and the construction of the Improvements, and to take such memoranda from and with regard thereto as may be desired.

(j) The Trustee shall not be required to give any bond or surety in respect of the execution of the said trusts and powers or otherwise in respect of the premises.

(k) Notwithstanding anything elsewhere in this Indenture with respect to the authentication of any Bonds, the withdrawal of any cash, the release of any property or any action whatsoever within the purview of this Indenture, the Trustee shall have the right, but shall not be required, to demand any showings, certificates,

opinions, appraisals or other information, or corporate action or evidence thereof, in addition to that by the terms hereof required as a condition of such action, by the Trustee deemed desirable for the purpose of establishing the right of the Authority to the authentication of any Bonds, the withdrawal of any cash or the taking of any other action by the Trustee.

(l) Before taking the action referred to in Section 8.03 or 8.08 hereof, the Trustee may require that a satisfactory indemnity bond be furnished for the reimbursement of all expenses to which it may be put and to protect it against all liability, except liability which is adjudicated to have resulted from its negligence or willful default in connection with any such action.

(m) all moneys received by the Trustee shall, until used or applied or invested as herein provided, be held in trust for the purposes for which they were received, but need not be segregated from other funds except to the extent required by law.

(n) No provision in this Indenture shall require the Trustee to expend or risk its capital or its own funds or to incur any financial liability in the exercise of its rights and powers and duties as Trustee under this Indenture.

*Section 9.02. Fees, Charges and Expenses of the Trustee and Paying Agents.* The Trustee shall be entitled to receive, as an inception fee, the sum designated by the Authority from moneys on deposit in the Cost of Issuance Account. The Trustee and any Paying Agents shall also be entitled to payment and reimbursement for reasonable fees for



their services rendered hereunder and all advances, counsel fees and other expenses reasonably and necessarily made or incurred by the Trustee in connection with such services solely from moneys made available as permitted by Section 5.09(b) hereof. Upon an Event of Default, but only upon an Event of Default, the Trustee shall have a first lien with right of payment prior to payment on account of principal of, premium, if any, and interest on any Bond upon the Trust Estate for the foregoing fees, charges and expenses incurred by the Trustee.

Section 9.03. *Notice to Bondholders if Default Occurs.* If a Default occurs of which the Trustee is by Section 9.01(h) hereof required to take notice or if notice of Default be given as therein provided, then the Trustee shall promptly give written notice thereof by registered or certified mail to the owner of each Bond shown by the list of Bondholders required by the terms of Section 4.06 hereof to be kept at the principal corporate trust office of the Trustee.

Section 9.04. *Intervention by the Trustee.* In any judicial proceeding to which the Authority or the Company is a party and which in the opinion of the Trustee and its counsel has a substantial bearing on the interests of owners of the Bonds, the Trustee may intervene on behalf of Bondholders and shall do so if requested in writing by the owners of at least twenty-five percent (25%) of the aggregate principal amount of Outstanding Bonds.

Section 9.05. *Successor Trustee.* Any corporation or association into which Trustee may be converted or merged, or with which it may be consolidated, or to which it may sell or transfer its trust business and assests

as a whole or substantially as a whole, or any corporation or association resulting from any such conversion, sale, merger, consolidation or transfer to which it is a party, shall be and become successor Trustee hereunder and vested with all of the title to the Trust Estate and all the trusts, powers, discretions, immunities, privileges and all other matters as was its predecessor, without the execution or filing of any instrument or any further act, deed or conveyance on the part of any of the parties hereto, anything herein to the contrary notwithstanding.

Section 9.06. *Resignation by the Trustee.* The Trustee and any successor Trustee may at any time resign from the trusts hereby created by giving thirty (30) days' written notice by registered or certified mail to the Authority and to the owner of each Bond as shown by the list of Bondholders required by Section 4.06 hereof to be kept by the Trustee, and such resignation shall not take effect until the appointment of a successor Trustee by the Bondholders or by the Authority.

Section 9.07. *Removal of the Trustee.* The Trustee may be removed at any time by an instrument or concurrent instruments in writing delivered to the Trustee and to the Authority and signed by the owners of a majority in aggregate principal amount of Outstanding Bonds.

Section 9.08. *Appointment of Successor Trustee by Bondholders.* In case the Trustee hereunder shall resign or be removed, or be dissolved, or shall be in course of dissolution or liquidation, or otherwise become incapable of acting hereunder, or in case it shall be taken under the control of any public officer or officers, or of a receiver appointed by a court, a successor may be appointed by

the owners of a majority in aggregate principal amount of Outstanding Bonds by an instrument or concurrent instruments in writing signed by such owners, or by their attorneys in fact duly authorized, a copy of which shall be delivered personally or sent by registered mail to the Authority. In case of any such vacancy, the Authority, by an instrument executed, attested and sealed by those of its officials who executed and attested the Bonds, may appoint a temporary Trustee to fill such vacancy until a successor Trustee shall be appointed by the Bondholders in the manner above provided; and such temporary trustee so appointed by the Authority shall immediately and without further act be superseded by the trustee appointed by the Bondholders; provided, however, that in the event the temporary trustee appointed by the Authority shall not be superseded by a trustee appointed by the Bondholders within six (6) months from the effective date of appointment by the Authority, the right of Bondholder to appoint a successor trustee shall be deemed to be waived and the trustee appointed by the Authority shall be deemed to be the Trustee hereunder. Notice of the appointment of a successor Trustee shall be given in the same manner as provided in Section 9.06 hereof with respect to the resignation of a Trustee. Every such Trustee appointed pursuant to the provisions of this Section shall be a trust company or a bank in good standing having a reported capital and surplus of not less than \$10,000,000 if there be such an institution willing, qualified and able to accept the trust upon customary terms.

Section 9.09. *Concerning Any Successor Trustee.* Every successor Trustee appointed hereunder shall execute,

acknowledge and deliver to its or his predecessor and also to the Authority and the Company an instrument in writing accepting such appointment hereunder, and thereupon such successor, without any further act, deed or conveyance, shall become fully vested with all the estates, properties, rights, powers, trusts, duties and obligations of its predecessor; but such predecessor shall, nevertheless, on the written request of the Authority, or of its successor, execute and deliver an instrument transferring to such successor all the estates, properties, rights, powers and trusts of such predecessor hereunder; and every predecessor the Trustee shall deliver all securities and moneys held by it as the Trustee hereunder to its successor. Should any instrument in writing from the Authority be required by any successor Trustee for more fully and certainly vesting in such successor the estate, rights, powers and duties hereby vested or intended to be vested in the predecessor, any and all such instruments in writing shall, on request, be executed, acknowledged and delivered by the Authority. The resignation of any Trustee and the instrument or instruments removing any Trustee and appointing a successor hereunder, together with all other instruments provided for in this Article, shall be filed or recorded by the successor Trustee in each recording office where the Indenture shall have been filed or recorded.

Section 9.10. *Appointment of Co-Trustee.* It is the purpose of this Indenture that there shall be no violation of any law of any jurisdiction (including particularly the law of the State) denying or restricting the right of banking corporations or associations to transact business as the Trustee in such jurisdiction. It is recognized that in



case of litigation under this Indenture or foreclosure under the Public Improvements Assessment and Lien, and in particular in case of the enforcement of any such instruments on Default, or in case the Trustee deems that by reason of any present or future law of any jurisdiction it may not exercise any of the powers, rights or remedies herein granted to the Trustee or hold title to the properties, in trust, as granted herein or in the Public Improvements Assessment and Lien, or take any other action which may be desirable or necessary that the Trustee appoint an additional individual or institution as a separate or Co-Trustee. The following provisions of this Section are adapted to these ends.

The Trustee may appoint an additional individual or institution as a separate or Co-Trustee, in which event each and every remedy, power, right, claim, demand, cause of action, immunity, estate, title, interest and lien expressed or intended by this Indenture to be exercised by or vested in or conveyed to the Trustee with respect thereto shall be exercisable by and vest in such separate or Co-Trustee but only to the extent necessary to enable such separate or Co-Trustee to exercise such powers, rights and remedies, and every covenant and obligation necessary to the exercise thereof by such separate or Co-Trustee shall run to and be enforceable by either of them.

Should any deed, conveyance or instrument in writing from the Authority be required by the separate or Co-Trustee so appointed by the Trustee for more fully and certainly vesting in and confirming to him or it such properties, rights, powers, trusts, duties and obligations, any and all such deeds, conveyances and instruments in writing shall, on request, be executed, acknowledged and

delivered by the Authority. In case any separate or Co-Trustee, or a successor to either, shall die, become incapable of acting, resign or be removed, all the estates, properties, rights, powers, trusts, duties and obligations of such separate or Co-Trustee, so far as permitted by law, shall vest in and be exercised by the Trustee until the appointment of a new Trustee or successor to such separate or Co-Trustee.

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Johnson  
DEPOSITION EXHIBIT 260  
1-24-90 LO  
AGREN, BLANDO & ASSOCIATES

#### CERTIFICATE OF QUALIFIED APPRAISER 1988A

This Certificate is rendered on behalf of Joseph L. Hastings Company (the "Appraiser") in connection with the issuance of an appraisal report dated January 4, 1988 (the "Appraisal") of selected parcels of property from the Stetson Hills Master Plan located northeasterly of Powers Boulevard and Barnes Road in the City of Colorado Springs, Colorado. The Appraisal has been issued by the Appraiser for the benefit of AmWest Development I, Limited Partnership (the "Company"). The Company is participating in the issuance of \$11,000,000 in aggregate principal amount of certain Landowner Assessment Lien Bonds, Series 1988A (the "Series 1988A Bonds") being



issued by the Colorado Springs-Stetson Hills Public Building Authority (the "Authority") pursuant to an Indenture of Trust, dated as of May 15, 1988 (the "Indenture"), between the Authority and The Central Bank and Trust Company of Denver, d/b/a Central Bank of Denver, A Banking Corporation, as trustee (the "Trustee").

In connection with the preparation of the Appraisal and the issuance of the Series 1988A Bonds, the undersigned Appraiser hereby certifies for the benefit of the Trustee as follows:

1. The Appraiser is a "Qualified Appraiser" with the meaning of such term as used in the Indenture. (See Exhibit A Attached).
2. The Appraisal constitutes a "Qualified Appraisal Report" within the meaning of such term as used in the Indenture.
3. The Summary of Appraisal Report dated January 4, 1988 and set forth as Appendix B to the Official Statement dated May 20, 1988 (the "Official Statement") prepared for use in connection with the offering and sale of the Series 1988A Bonds, constitutes a fair and accurate summary of the material provisions of the Appraisal.
4. The definition of market value for each of the properties described in the Appraisal is the same as the "As Is Value" for such property within the meaning of such term as used in the Indenture.

5. The method of calculating the bulk sale discount as set forth in the Appraisal produces a bulk sale discount which is the same as the calculation required by the Indenture for the Bulk Sale Discount.

6. The process of updating the Stetson Hills appraisal began in the fall of 1987, due to changes requested by the Building Authority; the process of continued [sic] over a period of many months. I have during this time received other comparable sales which I reviewed in the process but were not added to the appraisal report. These transactions were considered but did not materially alter the appraisal value of the parcels included in the appraisal report.

7. The discounting for bulk sale was computed in accordance with "Bulk Sale Discount" factors defined in the Indenture of Trust dated December 1, 1986, on pages 8 and 9. The mathematical computations of these factors is detailed in table 10.1 and 11.3. The appropriate Carry Costs Factors, Time Discounted Value, and Risk Profit Sales Factors account for the "Bulk Sales Discount" required by the Indenture of Trust.

"Public Improvements Assessment and Lien" means the agreement of that name of even date herewith between the Company and the Authority and recorded in the real property records of the Office of the County Clerk and Recorder of El Paso County, Colorado.

IN WITNESS WHEREOF, the undersigned has executed this Certificate on behalf of Joseph L. Hastings Company as of this 16th day of June, 1988.

JOSEPH L. HASTINGS COMPANY

By: /s/ Joseph L. Hastings  
Name: Joseph L. Hastings  
Title: M.A.I.

\_\_\_\_\_  
Crandall  
DEPOSITION EXHIBIT 331A  
4-16-90 LO  
AGREN, BLANDO & ASSOCIATES

(LOGO) Central Bank  
Denver

January 10, 1989

Mr. David J. Powers  
Mr. Charlie Malcombson  
Stetson Hills  
5455 North Union Boulevard  
Colorado Springs, CO 80918

RE: Stetson Hills PBA Landowner Assessment Lien  
Bond Series 1986A  
Account No. 80-5021

Gentlemen:

The Reserve Fund Requirement has been recalculated by the Trustee, in accordance with the requirements of the Indenture, as of December 31, 1988. The Requirement will increase by \$40,250 for the calculation period ending December 30, 1989. Quarterly installments will be due as

1515 Arapahoe Street/Denver, Colorado 80292/  
(303) 893-3456

set forth below in order to satisfy the Reserve Requirement.

<u>Date</u>	<u>Installment Due</u>	<u>Total Requirement</u>
March 15, 1989	\$10,062.50	\$1,469,812.50
June 15, 1989	10,062.50	1,479,875.00
September 15, 1989	10,062.50	1,489,937.50
December 15, 1989	10,062.50	1,500,000.00

The Reserve Fund investments that matured on December 29, 1988 were reinvested at Capital Federal in a certificate maturing on June 29, 1989. The total amount of the maturing CD's on December 29 equalled \$844,129.32. This resulted in a balance in the Reserve Fund that was \$62,620.53 in excess of the then current Reserve Requirement. This excess amount was attributable to investment earnings and was transferred out of the Reserve Fund in accordance with the Indenture. The CD purchased on December 29 was in the principal amount of \$781,508.79, bearing interest at 8.50% and maturing June 29, 1989. Please provide written confirmation that the Reserve Fund has been invested in accordance with your instructions.

Please provide instructions with respect to any rebate deposit required pursuant to section 5.11 of the Indenture. Last year you provided us with a certificate from your accountants regarding the calculation. We would appreciate again receiving a certification for the current year.

Please review Section 5.3 of the Development Agreement with respect to your obligations to provide certain reports and certifications to the Trustee. Those items required annually that are not required in connection with your

fiscal year end, were due to the Trustee not later than December 30, 1988. Please advise with respect to the status of these items.

Additionally, please recall that as a condition to accepting the appraisal prepared by Mr. Hastings in connection with the amendments to the Lien and the issuance of the Series 1988 bonds last June, it was agreed that a new appraisal, prepared by Zaleski and Associates, would be delivered to the Trustee by not later than year end. This has not been received to date.

Please provide written response to the foregoing requests not later than January 31, 1989. If the requirements as described above have not been satisfied, or adequate explanation provided as to why these requirements remain unsatisfied, Central Bank of Denver, as Trustee, will proceed with such actions as are permitted under the Indenture for the protection and benefit of the Bondholders at that time.

Please do not hesitate to contact me if you have any questions, and I appreciate your prompt attention to these matters. Thank you.

Cordially,  
/s/ Cheryl Crandall  
Cheryl A. Crandall  
Corporate Trust Officer

CAC:ah

c: Gregory Timm  
Gregory V. Johnson  
John Conrad  
Steven Jeffers

**Pederson**  
**DEPOSITION EXHIBIT 356**  
**3-1-90**  
**AGREN BLANDO & ASSOCIATES**

(LOGO)

**STETSON HILLS**  
5455 North Union Blvd.  
Colorado Springs, CO 80918  
(303) 528-1808

January 14, 1989

Ms. Cheryl A. Crandall  
Corporate Trust Officer  
Central Bank of Denver  
1515 Arapahoe Street  
Denver, Colorado 80902

Dear Ms. Crandall:

Thank you for reminding us of certain requirements set forth in the 1986A Colorado Springs Stetson Hills Public Building Authority. In review of the document we understand the requirement to be within 120 days of year end. If you would be so kind as to please provide me with copies of reports of compliance from last year. This would help me to prepare them without outside expense.

We have retained Zaleski and Associates to prepare a new appraisal at a cost of \$58,000.00. Thus far an amount of \$32,000.00 has been expended with a balance to complete of \$24,000.00. The expenditure of \$32,000.00 really brought forward only two comparable sales in 1988. One of those sales was to Christian Missionary Alliance of 5.0 acres at \$2.80 per square foot by Briargate Joint Venture. The other sale was to International Bible Society of 9.72 acres at \$1.75 per square foot by Northgate.



In a meeting with Zaleski and Associates on December 16, 1988 I was told that due to the depressed value of the two sales, tremendous over supply of ground and lack of demand, only a subjective appraisal would be possible at this time. Subjective in the sense that we were in their opinion going to see extremely soft market conditions for seven to ten years. This subjective opinion had to do with several plant closings in the Springs which was the cause for tremendous job loss!

In discussions with Zaleski and [sic] Associates what their subjective thought meant in appraisal value they said is a 60% to 65% drop. Frankly upon hearing this I told them to stop and not spend anymore of our money. I said after I looked into the matter I would get back to them. On a limited basis on my own I have done a review of sales which occurred in 1988. My findings have been the same two sales mentioned above and a couple of sales on South Academy Boulevard for which Zaleski and Associates said were not comparable.

It seems a waste of money on our part to spend any more money on this subjective appraisal approach. Certainly if you take a look at absorption and the two sales above in the master planned communities in Colorado Springs for 1988 we are all going to own this land into the next century. I intend to rest on an earlier appraisal as a more realistic look and do not intend to submit ourselves to this subjective approach of land values below cost of improvements, let alone land costs and soft costs.

I would appreciate your input on this matter.

Sincerely,

/s/ David J. Powers  
David J. Powers  
President

cc: Steven Jeffers  
John Conrad  
Gregory V. Johnson  
Gregory Timm  
Roy I. Pring  
Charlie Malcomson  
Jim Wilson

DJP/rkw

Smith  
DEPOSITION EXHIBIT 397  
4-6-90 LO  
AGREN, BLANDO & ASSOCIATES

(LOGO) Central Bank  
Denver

1515 Arapahoe Street  
Denver, CO 80292  
(303) 803-3456

April 10, 1989

\$11,000,000  
The Colorado Springs - Stetson Hills Public Building  
Authority Landowner Assessment Lien Bonds  
Series 1988A

Dear Bondholder:

Central Bank Denver, National Association, as Trustee for the above-referenced Bonds, hereby notifies you of the occurrence of certain Events of Default as set forth below:

1. An Event of Default has occurred under section 6.1(b) of the Development Agreement for failure to deliver to the Trustee the reports required by section 5.3 thereof. Such failure has continued for more than thirty (30) days after the written notice to the Authority which specified such failure and requested that it be remedied.
2. An Event of Default has occurred under section 8.01(a) of the Indenture as a result of the occurrence of the above Event of Default under the Development Agreement.
3. An Event of Default has occurred under section 8.01(c) of the Indenture due to the Authority's failure to perform under a covenant entered into by a letter of agreement dated May 13, 1988, among the Authority, AmWest Development I Limited Partnership (the "Company") and the Trustee. The Authority covenanted to cause to be delivered to the Trustee by not later than March 1, 1989, the appraisal referred to in such agreement. No such appraisal has been delivered to the Trustee, and such failure has continued for more than thirty (30) days after written notice to the Authority which specified such failure and requested that it be remedied.
4. An Event of Default has occurred under section 6.1(d) of the Public Improvements

Assessment and Lien (the "Lien") as a result of the occurrence of the above Events of Default under the Indenture.

The reports required to be filed with the Trustee under the Development Agreement include: the audited financial statements of the Company, a certificate of an independent public accountant that the Company has complied with the requirements of the Development Agreement with respect to distributions of profits and earnings, an accounting which sets forth information regarding property sales and the sales price received for property subject to the Lien, information regarding the status of the payment of taxes and assessments on property subject to the Lien, and a general certification by the Company that it is in compliance with all covenants and agreements under the Development Agreement and Lien.

The Lien and Indenture also require that the Company and Authority satisfy certain financial ratios in order to ensure that the appraised value of the property pledged to the Trustee and subject to the Lien is at all times adequate to fully secure the principal of and interest on the Bonds. The Company and the Authority have failed to certify to the Trustee, as is periodically required, that they are in compliance with all covenants under the bond documents, which certifications would include confirmation of compliance with those certain financial tests. Additionally, failure by the Company and the Authority to provide the Trustee with a current appraisal report, as required by the Indenture, makes it impossible for the Trustee to have independently verified whether there is

compliance, and, in fact, whether the land currently subject to the Lien is of sufficient value to secure the Bonds as required by the Indenture.

The above described Events of Default constitute failures of performance of convenents [sic] by the Company or the Authority. There has been no monetary default as of the date of this notice for any failure to pay principal or interest on the Bonds as the same have become due.

Please be advised that the Trustee holds in its possession of a Reserve Fund which is fully funded in an amount sufficient to pay one full year of interest on all Bonds and principal on any Bonds maturing on or before November 15, 1989, as the same become due.

The Trustee is currently reviewing the remedies for default with legal counsel. Owners of a majority in aggregate principal amount of Bonds outstanding have the right under the Indenture to direct the proceedings taken in connection with the enforcement of the terms of the Indenture, provided satisfactory indemnity is furnished to the Trustee. The Trustee will provide subsequent notification to all owners of the Bonds upon completion of legal review in order to advise owners of the various remedies which are available to the Trustee to pursue on their behalf and upon their direction.

Please refer any questions to Ken Buckius at 303/820-4261.

Thank you for your attention to this matter.

CENTRAL BANK DENVER,  
National Association,  
as Trustee

Smith  
DEPOSITION EXHIBIT 398  
4-6-90 LO  
AGREN, BLANDO & ASSOCIATES

(LOGO) Central Bank  
Denver

1515 Araphoe Street  
Denver, CO 80292  
(303) 893-3456

October 18, 1989

\$11,000,000  
The Colorado Springs - Stetson Hills Public Building  
Authority Landowner Assessment Lien Bonds  
Series 1988A

Dear Bondholder:

Central Bank Denver, N.A., as Trustee, has previously provided you notice of non-monetary Events of Default by Stetson Hills Public Building Authority and AMWEST Development I Limited Partnership. This letter is to notify you that the Property Owner, AMWEST Development I Limited Partnership has failed to pay Allocated Assessment Charges in amounts sufficient to replenish the Reserve Fund by the due date established by the Trustee in accordance with Section 5.07 of the Trust Indenture. Failure to timely replenish the Reserve Fund is deemed to be a monetary Event of Default under Section 6.1(a) of the Public Improvements Assessment and Lien. AMWEST Development I Limited Partnership was notified on October 12, 1989, that failure to cure said Default within twenty (20) days of such notice as required in the Public Improvements Assessment and Lien will cause the



occurrence of an Event of Default to be continuing under the Public Improvements Assessment and Lien, Section 6.1(a) and 6.3, and will also cause the occurrence of an Event of Default under Section 8.01(a) of the Trust Indenture. If said default is not cured within the 20 day period, Central Bank Denver, N.A., as Trustee, will notify holders of the failure to cure, and of the courses of action available to the Trustee under the Indenture.

Because of the previous non-monetary Events of Default, Central Bank Denver, N.A., as Trustee, is making arrangements for the inspection of all books and records in the possession of the Authority by an independent accountant in accordance with Section 4.05 of the Trust Indenture. The Trustee has also obtained an appraisal report prepared by Freeman and Associates relative to the real property and improvements thereon which secure the bonds and the conclusions are as follows:

1988A Bond Collateral

Gross Retail Lot Sales (Values)	\$13,706,825
Net Discounted Retail Lot Sales (Values)	7,348,000
Bulk Sale Value	962,500

This information is provided for your consideration for future action to be taken by the Trustee. Please refer any questions to Donna Crump (303) 820-4396 or Ken Buckius (303) 820-4261.

Central Bank Denver, N.A.  
Trustee

Smith  
DEPOSITION EXHIBIT 401  
4-6-90 LO  
AGREN, BLANDO & ASSOCIATES

(LOGO) Central Bank  
Denver

1515 Arapahoe Street  
Denver, CO 80292  
303 893-3456

November 15, 1989

\$11,000,000  
The Colorado Springs - Stetson Hills Public Building  
Authority Landowner Assessment Lien Bonds  
Series 1988A

Dear Bondholder:

On October 18, 1989, we notified you that a monetary Event of Default had occurred under Section 6.1(a) of the Public Improvements Assessment and Lien and 8.01(e) of the Trust Indenture and that the Property Owners, AMWEST Development I Limited Partnership, had been given a period of twenty (20) days to cure said Event of Default. This is to notify you that said Event of Default was not cured during the time allowed.

Central Bank Denver, N.A., as Trustee, in accordance with Section 8.02 of the Trust Indenture, hereby declares the principal of all outstanding bonds and the interest accrued thereon to November 15, 1989, to be immediately due and payable. As provided in Section 8.07 of the Trust Indenture, monies currently on deposit with the Trustee in the amount of \$501,834.70 shall be applied to the principal and interest due, without preference or priority

of principal over interest or of interest over principal, ratably, according to the amounts due, respectively, for principal and interest, to the persons entitled thereto without any discrimination or privilege. A pro-rata payment of principal and interest due will be made to each bondholder upon presentation of the outstanding bonds to our offices as instructed below. Upon payment of a portion of the principal and interest due, a replacement bond, representing the outstanding amount of principal not paid, will be issued and returned to each bondholder.

The Trustee is considering foreclosure of the lien with respect to all of the property. Any monies received by the Trustee pursuant to such proceedings, after payment of the costs and expenses of the proceedings resulting in the collection of such monies, shall be applied, when received, in the same manner as described above.

If foreclosure action is taken, upon its completion, the Trustee will review further options available with respect to sale of the property, and will present such options to all bondholders for review. We will keep you informed of significant developments.

Please bring your bonds to Central Bank Denver, N.A., 1515 Arapahoe Street, Denver, CO 80292, ATTN: Bond Services Department, Tower II, 7th Floor, or send to:

Central Bank Denver, N.A.  
P. O. BOX 17289, T.A.  
Denver, CO 80217  
ATTN: Bond Services Department

Central Bank Denver, N.A.  
Trustee

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLORADO

Civil Action No. 89-F-1250 and  
Civil Action No. 89-F-1806

FIRST INTERSTATE BANK OF DENVER, N.A., and  
JACK K. NABER,  
Plaintiffs,

vs.

KIRCHNER MOORE & COMPANY, d/b/a DBLKM Inc.;  
HANIFEN IMHOFF, INC.;  
THE COLORADO SPRINGS-STETSON HILLS PUBLIC  
BUILDING AUTHORITY;  
ROY I. PRING; and  
THE CENTRAL BANK & TRUST COMPANY OF  
DENVER,  
Defendants,

and

KIRCHNER MOORE & COMPANY, d/b/a DBLKM Inc.,  
Third-Party Plaintiff,

vs.

RESOLUTION TRUST CORPORATION, as Conservator  
for  
Capitol Federal Savings and Loan Association of Denver;  
AMWEST DEVELOPMENT CORP.;  
AMWEST DEVELOPMENT I LIMITED PARTNERSHIP;  
and  
Third-Party Defendants.

---

ORDER ON MOTIONS FOR SUMMARY JUDGMENT

(Filed June 28, 1990)

Sherman G. Finesilver, Chief Judge

THIS MATTER comes before the court on various motions of parties. This litigation arises from the alleged fraudulent issuance and sale of bonds in violation of federal securities law. Plaintiffs bring this cause of action pursuant to § 10(b) of the Securities Exchange Act of 1934 and rules promulgated thereunder by the Securities Exchange Commission. 15 U.S.C. § 78a *et seq.* Jurisdiction arises pursuant to 28 U.S.C. § 1331. The factual and procedural background of this litigation has been outlined in prior orders and will not be repeated here.

Three motions for summary judgment have been filed pursuant to Fed.R.Civ.P. 56. Defendant Roy I. Pring moves for summary judgment of claims of plaintiffs First Interstate Bank of Denver, N.A. and Jack K. Naber. Defendant Central Bank & Trust Company of Denver moves for summary judgment of plaintiffs' claim. Third-party defendant Resolution Trust Corporation as Conservator for Capitol Federal Savings and Loan Association of Denver moves for summary judgment of third-party claim of defendant and third-party plaintiff Kirchner Moore & Company.

#### I.

Summary judgment is proper where there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(c); *Willner v. Budig*, 848 F.2d 1032, 1033-34 (10th Cir.), *cert. denied*, \_\_\_ U.S. \_\_\_, 109 S.Ct. 840 (1989). The plain language of Rule 56(c) mandates the entry of summary judgment against the party who fails to make a showing that is sufficient to establish the existence of an element essential to that

party's case, and on which that party will bear the burden of proof at trial. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). In reviewing a motion for summary judgment, the court must view the evidence in the light most favorable to the party opposing the motion, and resolve all doubts in favor of the existence of triable issues of fact. *World of Sleep, Inc. v. La-Z-Boy Chair Co.*, 756 F.2d 1467, 1474 (10th Cir.), *cert. denied*, 474 U.S. 823 (1985); *Ross v. Hilltop Rehabilitation Hosp.*, 676 F.Supp. 1528 (D. Colo. 1987).

In *Celotex v. Catrett*, 477 U.S. 317 (1986), the Supreme Court held that the language of Rule 56(c) does *not* require the moving party to show an *absence* of issues of material fact in order to be awarded summary judgment. *Id.*, 477 U.S. at 322. The movant merely has the initial responsibility of informing the court of the basis for the motion, and identifying those portions of the record it believes show a lack of genuine issue. *Id.*, 477 U.S. at 323. This burden is discharged merely by pointing out to the court there is an absence of evidence to support the non-movant's case. *Id.*, 477 U.S. at 325. On the other hand, the non-movant has the burden of showing that there *are* issues of material fact to be determined. *Id.*, 477 U.S. at 322-23. See Childress, *A New Era for Summary Judgments: Recent Shifts at the Supreme Court*, 116 F.R.D. 183 (1987).

#### II.

Defendant Roy I. Pring ("Pring") moves for summary judgment of claims of plaintiffs First Interstate Bank of Denver, N.A. and Jack K. Naber (the "plaintiffs"). Plaintiffs contend Pring is (1) primarily liable under Section 10(b) of the Securities Exchange Act of 1934 and Rule



10b-5 of the Securities Exchange Commission and is (2) secondarily liable as (a) participant in conspiracy to commit fraud under Rule 10b-5; (b) controlling person under § 20 of the Securities Exchange Act; and (c) aider and abettor under Rule 10b-5.

Plaintiffs fail to oppose Pring's motion as to primary liability and as to conspiracy liability.

In order to establish liability of Pring as controlling person pursuant to § 20 of the Securities Exchange Act plaintiffs must prove the purported controlling person (1) actively participated in overall management and operation of the controlled entity and (2) actively participated, in some meaningful sense, in the fraud perpetrated by that entity. *Harrison v. Enventure Capital Group, Inc.*, 666 F.Supp. 473, 478 (W.D.N.Y. 1987); *Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973) (*en banc*). Pring correctly states plaintiffs must offer evidence that Pring controlled the developer, AmWest I Development Limited Partnership ("AmWest"), and participated in a fraud committed by the developer or the issuer of the Bonds, the Colorado Springs-Stetson Hills Public Building Authority. In opposition plaintiffs state Pring owned or controlled the collateral property, was a substantial interest holder in AmWest and was a principal creditor of AmWest. Pring was a creditor of AmWest. His last loan to AmWest was made in 1985. Pring was no longer an officer of AmWest when the Official Statement was prepared or when the Bonds were issued. Even taken as true plaintiffs' evidence fails to establish that Pring actually participated in the alleged fraud of the developer or the issuer of the Bonds. *Seattle-First National Bank v. Carlstedt*, 678 F.Supp.

1543 (W.D.Okla. 1987). There is no genuine issue of material fact in regard to active participation in the alleged fraud in order to establish controlling person liability.

In order to establish aider and abettor liability under Rule 10b-5 plaintiff must prove (1) primary violation of Rule 10b-5 by another; (2) knowledge of the violation by alleged aider and abettor; and (3) substantial assistance by the aider and abettor. *Feldman v. Pioneer Petroleum, Inc.*, 606 F.Supp. 916 (W.D.Okla. 1985), *aff'd*, 813 F.2d 296 (10th Cir. 1987); *Johnson v. Chilcott*, 658 F.Supp. 1213 (D.Colo. 1987). Plaintiffs contend Pring's silence and inaction in the face of undervalued collateral constitute substantial assistance to establish liability as aider and abettor. However silence and inaction are not bases to establish substantial assistance absent an additional fiduciary duty to disclose. *Dirks v. SEC*, 463 U.S. 646, 653-64 (1983); *Chiarella v. United States*, 445 U.S. 222, 227-35 (1980). Plaintiffs fail to offer persuasive authority or evidence to establish that Pring breached any fiduciary duty owed plaintiffs. Plaintiffs fail to establish a material fact as to the third element necessary for aider and abettor liability.

### III.

Defendant Central Bank & Trust Company of Denver ("CBD") moves for summary judgment of plaintiffs' claim against CBD. Plaintiffs contend Central Bank is secondarily liable under Section 10(b) of the Securities Exchange Act and Rule 10b-5 of the Securities Exchange Commission as aider and abettor. The elements of aider and abettor liability are identified above.

Plaintiffs allege CBD knowingly took affirmative steps to postpone review of the so-called Hastings appraisal, a key element in the alleged scheme to defraud. Plaintiffs contend this was reckless behavior by CBD, thereby satisfying the knowledge or scienter requirement of aider and abettor liability. However the scienter requirement may not be satisfied by showing recklessness absent an additional duty to disclose. *National Union Fire Ins. Co. of Pittsburgh v. Eaton*, 701 F.Supp. 1031 (S.D.N.Y. 1988). Plaintiffs do not raise a genuine issue of material fact as to CBD's knowledge of fraud allegedly perpetrated by AmWest or as to additional duty to disclose owed by CBD.

## IV.

Third-party defendant Resolution Trust Corporation ("RTC") as Conservator for Capitol Federal Savings and Loan Association of Denver ("Capitol Federal") moves for summary judgment of third-party claim of defendant and third-party plaintiff Kirchner Moore & Company ("KMC"). KMC brings a claim for contribution, based on Capitol Federal's liability under § 10b and Rule 10b-5 as an aider and abettor. The elements of aider and abettor liability are identified above. KMC has not presented evidence to establish Capitol Federal, at the time it lent an additional \$1.5 million to AmWest, had any knowledge of fraud allegedly committed by AmWest or any other entity. The scienter requirement for aider and abettor liability may not be satisfied by showing recklessness absent an additional duty to disclose. *National Union Fire Ins. Co. of Pittsburgh v. Eaton*, 701 F.Supp. 1031 (S.D.N.Y. 1988). KMC does not raise a genuine issue of material fact

in regard to Capitol Federal's knowledge of the alleged fraud or as to a duty to disclose.

## V.

Defendants Central Bank, Hanifen Imhoff, Inc. and Roy I. Pring have filed a motion to compel depositions of plaintiffs' expert witnesses. However the deadline for completion of discovery has passed. The motion to compel is denied.

## VI.

ACCORDINGLY IT IS ORDERED that the motion of Roy I. Pring for leave to file reply brief in excess of ten pages, filed June 20, 1990, is GRANTED. The reply brief is deemed filed through. Plaintiffs' motion for leave to submit supplemental memorandum respecting Pring's motion for summary judgment, filed June 21, 1990, is GRANTED. The supplemental memorandum is deemed filed through.

IT IS FURTHER ORDERED that the motion of RTC for leave to file reply brief in excess of ten pages, filed June 20, 1990, is GRANTED. The reply brief is deemed filed through.

IT IS FURTHER ORDERED that the motion for summary judgment of Roy I. Pring pursuant to Fed.R.Civ.P. 56 is GRANTED. The Clerk of the Court is DIRECTED to enter judgment in favor of defendant Roy I. Pring and against plaintiffs First Interstate Bank of Denver, N.A. and Jack K. Naber.



IT IS FURTHER ORDERED that the motion for summary judgment of Central Bank & Trust Company of Denver pursuant to Fed.R.Civ.P. 56 is GRANTED. The Clerk of the Court is DIRECTED to enter judgment in favor of Central Bank & Trust Company of Denver and against plaintiffs First Interstate Bank of Denver, N.A. and Jack K. Naber.

IT IS FURTHER ORDERED that the motion for summary judgment of Resolution Trust Corporation as Conservator for Capitol Federal Savings and Loan Association of Denver pursuant to Fed.R.Civ.P. 56 is GRANTED. The Clerk of the Court is DIRECTED to enter judgment in favor of third-party defendant Resolution Trust Corporation as Conservator for Capitol Federal Savings and Loan Association of Denver and against defendant and third-party plaintiff Kirchner Moore & Company.

IT IS FURTHER ORDERED that the motion to compel of defendants Central Bank, Hanifen Imhoff, Inc. and Roy I. Pring, filed June 21, 1990, is DENIED.

IT IS FURTHER ORDERED that remaining parties are DIRECTED to file a Second Amended Pretrial Order on or before noon on July 5, 1990. Counsel for plaintiffs are DIRECTED to take the lead in preparation of the Pretrial Order. All counsel are DIRECTED to ensure that the Pretrial Order accurately reflects all remaining viable claims of parties and is complete in all respects.

The court strongly discourages pretrial motions. Evidentiary matters will be addressed at trial.

The court is in receipt of KMC's Notice of Name Change, filed June 25, 1990. The caption shall reflect Kirchner Moore & Company is now doing business as DBLKM Inc.

Done this 26th day of June 1990 at Denver, Colorado.

By the Court:

/s/ Sherman G. Finesilver  
Sherman G. Finesilver,  
Chief Judge  
United States District Court

UNITED STATES DISTRICT COURT  
OFFICE OF THE CLERK  
DISTRICT OF COLORADO

JAMES R. MANSPEAKER, CLERK

ROOM C-145  
UNITED STATES COURTHOUSE  
1929 STOUT STREET  
DENVER, COLORADO 80294  
PHONE (303) 844-3433  
FTS 564-3433

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Denver, CO 80202

Adam M. Dalmy, Esq.  
John E. Bush, Esq.  
Central Bank of Denver  
P.O. Box 5548 T.A.  
Denver, CO 80217

Magistrate D.E. Abram

RE: 89-F-1250, FIRST INTERSTATE BANK OF DENVER  
v. KIRCHNER MOORE & CO., et [sic] 89-F-1806,  
IDS HIGH YIELD TAX-EXEMPT FUND v.  
KIRCHNER MOORE & CO., et a [sic]

Enclosed please find a copy of ORDER DATED 6/26/90,  
entered by Chief Judge Sherman G. Finesilver in the  
referenced matter.

JAMES R. MANSPEAKER, CLERK  
BY: /s/ Patricia J. Allen  
Deputy Clerk

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLORADO

Civil Action No. 89-F-1250 and  
Civil Action No. 89-F-1806

FIRST INTERSTATE BANK OF DENVER, N.A., and  
JACK K. NABER,

Plaintiffs,

v.

KIRCHNER MOORE & COMPANY, d/b/a  
DBLKM, INC.;  
HANIFEN IMHOFF, INC.;  
THE COLORADO SPRINGS-STETSON HILLS PUBLIC  
BUILDING AUTHORITY;  
ROY I. PRING; and  
THE CENTRAL BANK & TRUST COMPANY OF  
DENVER,

Defendants,

and

KIRCHNER MOORE & COMPANY, d/b/a DBLKM,  
INC.,

Third Party Plaintiff,

v.

RESOLUTION TRUST CORPORATION, as Conservator  
for Capitol Federal Savings and Loan Association of  
Denver; AMWEST DEVELOPMENT CORP.; AMWEST  
DEVELOPMENT I LIMITED PARTNERSHIP;

Third Party Defendants.

JUDGMENT  
(Filed July 3, 1990)

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PURSUANT TO and in accordance with the Order on Motions for Summary Judgment entered June 26, 1990, by the Honorable Sherman G. Finesilver, Chief Judge, it is

ORDERED that judgment is entered in favor of the defendants, Roy I. Pring and Central Bank & Trust Company of Denver, and against the plaintiffs, First Interstate Bank of Denver, N.A. and Jack K. Naber, and the action and complaint are dismissed as to these defendants only. It is

FURTHER ORDERED that judgment is entered in favor of third party defendant Resolution Trust Corporation, as Conservator for Capitol Federal Savings and Loan Association of Denver, and against defendant and third-party plaintiff Kirchner Moore & Company. The third-party complaint is dismissed as to this defendant only.

DATED at Denver, Colorado, this 3rd day of July, 1990.

FOR THE COURT:

JAMES R. MANSPEAKER, Clerk

By: /s/ Stephen P. Ehrlich  
Stephen P. Ehrlich  
Chief Deputy Clerk

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IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLORADO

Civil Action No. 89-F-1250

FIRST INTERSTATE BANK OF DENVER, N.A., and  
JACK K. NABER,

Plaintiffs

v.

KIRCHNER MOORE & COMPANY, et al.,

Defendants.

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ORDER PURSUANT TO RULE 54(B)  
ENTERING FINAL JUDGMENT AS TO PLAINTIFFS'  
CLAIMS AGAINST DEFENDANTS CENTRAL  
BANK AND PRING  
(Filed Oct. 23, 1990)

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THIS MATTER COMES BEFORE THE COURT upon "Plaintiffs' Motion for Entry of Final Judgment Against Defendants Pring and Central Bank." Having reviewed the Motion, and being well advised with respect to the status of this litigation and as to the claims of plaintiffs against these particular defendants, the Court hereby,

FINDS AND DETERMINES PURSUANT TO RULE 54(b) that there is no just reason for delay as to the entry of final judgment as to plaintiffs' claims against defendants Pring and Central Bank; and it is, hereby,

ORDERED, that as to the claims of plaintiffs against defendants Central Bank and Pring, and upon the grounds previously set forth in this Court's "Order on

Motions for Summary Judgment" dated June 26, 1990, final judgment shall be and hereby is entered against plaintiffs and in favor of defendants Pring and Central Bank.

DONE AND SIGNED this 23 day of October, 1990.

BY THE COURT:

/S/ Sherman G. Finesilver  
Sherman G. Finesilver  
 United States District Judge

UNITED STATES DISTRICT COURT  
 OFFICE OF THE CLERK  
 DISTRICT OF COLORADO

JAMES R. MANSPEAKER, CLERK  
 ROOM C 145  
 UNITED STATES COURTHOUSE  
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Oct. 23, 1990

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Magistrate D.E. Abram

RE: 89-F-1250, FIRST INTERSTATE BANK OF DENVER  
 v. KIRCHNER MOORE & CO., et [sic]  
 89-F-1806, IDS HIGH YIELD TAX-EXEMPT FUND v.  
 KIRCHNER MOORE & CO., et [sic]

Enclosed please find a copy of ORDER PURSUANT TO  
R.54 (b) ENTERING FINAL JUDGMENT AS TO PLTF'S  
CLAIMS AGAINST DEFTS. CENTRAL BANK AND  
PRING DATED Oct. 23, 1990 entered by Chief Judge  
 Sherman G. Finesilver in the referenced matter.

JAMES R. MANSPEAKER, CLERK  
 BY: /s/ N. Hatcher  
 Deputy Clerk

PUBLISH

UNITED STATES COURT OF APPEALS  
 TENTH CIRCUIT

FIRST INTERSTATE BANK	)	
OF DENVER, N.A.	)	
and JACK K. NABER,	)	
Plaintiffs-Appellants,	)	
v.	)	No. 90-1315
ROY I. PRING and CENTRAL	)	
BANK AND TRUST	)	
COMPANY OF DENVER,	)	
Defendants-Appellees.	)	

Appeal from the United States District Court  
 for the District of Colorado  
 (D.C. Nos. 89-F-1250 and 89-F-1806)  
 (Filed July 8, 1992)

Miles M. Gersh (Laurie K. Rottersman, also of Gersh & Danielson; and Edwin S. Kahn of Kelly/Haglund/Garnsey & Kahn, with him on the briefs), Denver, Colorado, for Plaintiffs-Appellants.

Miles C. Cortez, Jr. (Stephen J. Hensen with him on the briefs), Cortez & Friedman, Denver, Colorado, for Defendant-Appellee Roy I. Pring.

Tucker K. Trautman (Neal S. Cohen and Polly A. Atkinson with him on the briefs), Ireland, Stapleton, Pryor &

Pascoe, Denver, Colorado, for Defendant-Appellee Central Bank of Denver.

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Before LOGAN and TACHA, Circuit Judges, and BRIMMER, District Judge.\*

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LOGAN, Circuit Judge.

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Plaintiffs First Interstate Bank of Denver, N.A. and Jack K. Naber appeal from the district court's grant of summary judgment for defendants Roy I. Pring (Pring) and Central Bank of Denver (Central Bank). Plaintiffs assert claims under § 10(b) and § 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) and 78t(a), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5.

# I

The securities involved in this case are \$11 million in bonds issued in June 1988 by the Colorado Springs-Stetson Hills Public Building Authority (the Authority).<sup>1</sup> Previously, in 1986, the Authority had issued \$15 million in bonds. The 1986 and 1988 bonds were similar. Both were issued to reimburse the developer for the cost of public improvements in a planned residential and commercial development in Colorado Springs called Stetson Hills.

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\* The Honorable Clarence A. Brimmer, Chief Judge, United States District Court for the District of Wyoming, sitting by designation.

<sup>1</sup> The Authority defaulted early in the litigation. Plaintiffs settled claims against the underwriters of the 1988 bonds.

Bondholders were to be repaid from assessments paid to the developer by commercial builders, or from a reserve fund. The bonds were secured by "landowner assessment liens" covering approximately 250 acres for the 1986 bond issue and approximately 272 acres for the 1988 bond issue. Under the bond covenants the land subject to the liens was required to be worth at least 160% of the bonds' outstanding principal and interest (the 160% test). Plaintiffs purchased some of the 1988 bonds, which later went into default.

The developer of Stetson Hills was AmWest Development I Limited Partnership (AmWest L.P.). The sole general partner of AmWest L.P. was AmWest Development Corporation (AmWest). Three AmWest officers were the only members of the board of directors of the Authority, including David J. Powers, AmWest's majority shareholder and chairman of AmWest's board of directors, and Gregory D. Timm, AmWest's president and a member of its board.

Defendant Pring was involved in the Stetson Hills development as one of the original owners of the property, as an investor in AmWest L.P., and as a creditor, officer, and director of AmWest. Pring and his family in 1983 entered into an option agreement with AmWest to sell the 2135 acres that became the Stetson Hills property.<sup>2</sup> The optionee was changed from AmWest to AmWest L.P. in 1986. AmWest L.P. then partially exercised the option,

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<sup>2</sup> Pring and his wife owned 51% of the Stetson Hills property; other members of Pring's family owned the remaining 49%. In entering the option agreement Pring acted as attorney in fact for the other members of his family.

purchased portions of the property, and began development. Pring and his family continued to own, subject to the option agreement, the remainder of the land within Stetson Hills.

Pring and his family formed Pring Investments, Ltd., a limited partnership, with Pring as the sole general partner; Pring Investments, Ltd. later became a twenty percent shareholder of AmWest. Pring and his wife made a loan of \$1.37 million to AmWest; this loan later was converted into a limited partnership contribution in Amwest L.P. whereby Pring and his wife each came to hold 17.5% interests in AmWest L.P. Pring and his wife also made a loan of \$5 million to AmWest L.P. Beginning in 1983 Pring was a vice-President<sup>3</sup> and director of AmWest. In February 1988, before the 1988 bonds were issued, his term as vice-president expired; in December 1988, after the 1988 bonds were issued, he resigned as director.

Central Bank served as the indenture trustee for both bond issues. In January 1988 Central Bank received an "updated" appraisal of the land securing the 1986 bonds that also included the land proposed to secure the 1988 bonds.<sup>4</sup> This appraisal was performed by Joseph Hastings, the appraiser who in 1986 had performed the original appraisal of the land securing the 1986 bonds. The

<sup>3</sup> Pring and others state that he was only an "honorary" vice-president.

<sup>4</sup> Central Bank rejected the "updated" appraisal because it combined the property securing the 1986 bonds and that proposed to secure the 1988 bond issue. The appraiser, Joseph Hastings, later separated the appraisals.

updated appraisal showed land values essentially unchanged from the earlier 1986 appraisal.

Thereafter Central Bank became aware of serious concerns about the adequacy of the security for the 1986 bonds and the accuracy of the Hastings appraisal. Central Bank received from the senior underwriter of the 1986 bonds a letter that expressed concern that the 160% test was not being met. The letter also expressed concern about declining property values in Colorado Springs and the fact that they were operating on an appraisal that was over sixteen months old. The letter suggested that the Authority may have given "false or misleading certifications" of compliance with the bond covenants. I R. tab 12, ex. G at 455. Subsequently, after reviewing the updated Hastings appraisal, the 1986 underwriter wrote a second letter to Central Bank expressing serious concerns that the updated appraisal was using outdated<sup>5</sup> real estate values.

<sup>5</sup> The letter closed with the following two paragraphs:

At this date we are operating on an appraisal that is over 16 months old. In light of the declining property values in Colorado Springs and the foreclosure sales, many of which have occurred within the vicinity of the collateral, an appraisal that reflects property values similar to those utilized for the 1986 appraisal of record should be suspect and not relied on without further independent check. As Trustee, you have the authority to name an independent appraisal if you are not satisfied.

It appears that the officers of the Stetson Hills Building Authority have failed to conform to the Bond Covenants to which they agreed. In the interest of the bondholders I call upon you to the [sic] enforce the covenants or Invoke the Remedies. It is our opinion that, based on your statement to us and based on



Central Bank investigated. Some information contradicted the 1986 underwriter's concerns.<sup>6</sup> Central Bank asked its own in-house appraiser to review the Hastings updated appraisal. He did so, expressed concerns about the age of comparable sales used and the methodology used, and suggested that there be an independent review of the appraisal. Apparently Central Bank trust officer Cheryl Crandall calculated that even under the Hastings appraisal, the collateral value did not meet the 160% test. See I R. tab 12, ex. B at 115. In light of all the foregoing, as trustee for the 1986 bonds, in a letter dated March 22, 1988, Central Bank required "that an independent review of the appraisal be conducted by a different appraiser." I R. tab 12, ex. I. Central Bank's letter to Timm stated three reasons for requiring an independent review: (1) the comparable sales data was outdated; (2) the methodology did not consider a bulk sale in a forced liquidation context;

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the project analysis, in addition to a reserve fund deficiency the Stetson Hills Public Building Authority is not meeting either the 110% or the 160% Test.

I R. tab 12, ex. G at 456.

<sup>6</sup> Central Bank inquired as to why the values in the updated appraisal were substantially unchanged from the original appraisal despite declines in local real estate values. A representative of AmWest and the Authority, Timm, said the reason was that \$10 million in improvements had been added to the property since the original appraisal. Timm wrote Central Bank's trust officer handling the 1986 bonds that the concerns expressed in the 1986 underwriter's letter were "unfounded." II Supp. R. tab 65. In addition, a different underwriter for the planned 1988 bond issue disputed several things in the 1986 underwriter's letters, including the method of calculating the 160% test and the suggestion that the Authority may have made false or misleading certifications. See II Supp. R. tab 72, ex. 72B.

and (3) considering the local real estate market the values appeared "unjustifiably optimistic." *Id.*

Thereafter there was a flurry of meetings and communications between Central Bank and Timm and others.<sup>7</sup> The ultimate result was that Central Bank agreed to delay an independent review of the Hastings updated appraisal until the end of the year, approximately six months after the closing on the 1988 bond issue.

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<sup>7</sup> On March 31 a Central Bank vice-president, Ken Buckius, met with Timm and representatives of the underwriter for the proposed 1988 bonds. Timm assured Buckius and the others that the Hastings appraisal, in fact, had considered more recent comparable sales and these had not materially affected the values. Timm also said that Hastings had used the proper methodology. Apparently Timm indicated a willingness to add approximately \$2 million worth of property to the 1986 assessment lien to bring the 160% test into compliance. Timm offered to have Hastings provide a certification regarding the updated appraisal. Timm objected to Central Bank's requirement of an independent review of the Hastings updated appraisal and offered instead to have a different appraiser do a new appraisal at the end of calendar year 1988.

Central Bank's trust committee met on or about April 5 to consider Timm's proposal to delay the independent review. The committee agreed to accept the proposal. This agreement, with conditions that included adding approximately \$2 million worth of property to the assessment lien, was conveyed to Timm in a letter dated April 8 from Buckius. See II Supp. R. tab 75. Thereafter, on May 13, a little more than one month before the closing on the 1988 bonds, Timm sent a letter to Central Bank on behalf of the Authority and the developer. The letter indicated that annual appraisals of the land securing the 1986 bonds and the proposed 1988 bonds would be provided, with the first of these to be completed within ninety days of December 1, 1988. Buckius countersigned the letter, signifying Central Bank's See II Supp. R. tab 240.

At least by March 1988 Pring knew that the appraisal had been questioned and that AmWest was experiencing or anticipating cash flow problems. Pring had communications with Timm in which AmWest expressed a need to acquire additional land under the option agreement. AmWest proposed that, instead of Pring receiving cash for the land purchase, Pring finance the purchase and requested that Pring agree to "cash flow arrangements." Pring refused.<sup>8</sup> It is undisputed that Pring stayed silent and took no action to bring what he knew to the attention of plaintiffs. From the proceeds of the 1988 bond issue Pring received almost \$2 million from AmWest L.P. as payment for land purchases and as interest due on Pring's \$5 million loan to AmWest L.P.

The December 1988 appraisal was begun, but the Authority refused to complete it. The 1988 bondholders were notified of the Authority's technical default. Thereafter, the Authority defaulted on payments on the 1988 bonds.

Plaintiffs allege that the 1988 bonds were sold as part of a fraudulent scheme. Plaintiffs allege that the official statement for the 1988 bonds was materially false and misleading by, inter alia, (1) representing the Hastings updated appraisal as being reliable, prudent, and correct; and (2) failing to disclose certain facts, including that Pring had refused to extend additional credit to AmWest,

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<sup>8</sup> The record includes a letter from Timm to Pring with the following handwritten notation at the bottom: "Met with [Timm]. Told him I had as much money involved in AmWest now, as I ever intend to have. I will not loan more money or forego payments due us, voluntarily." I R. tab 13, ex. G.

that Pring would receive almost \$2 million from the bond proceeds, that serious concerns had been raised about the accuracy of the Hastings updated appraisal, that Central Bank had required an independent review of the appraisal, that the developer had refused to provide it, and that Central Bank later had agreed to delay the independent review until December 1988.

## II

We review de novo the district court's summary judgment rulings. *Eastman Kodak Co. v. Westway Motor Freight, Inc.*, 949 F.2d 317, 319 (10th Cir. 1991). We apply the same standard as the district court: "[s]ummary judgment is appropriate 'if . . . there is no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law.'" *Id.* (quoting Fed. R. Civ. P. 56(c)). We must view the evidence in the light most favorable to the party opposing summary judgment. *World of Sleep, Inc. v. La-Z-Boy Chair Co.*, 756 F.2d 1467, 1474 (10th Cir.), *cert. denied*, 474 U.S. 823 (1985). If a reasonable trier of fact could return a verdict for the nonmoving party, summary judgment is inappropriate. *See Windon Third Oil & Gas Drilling Partnership v. FDIC*, 805 F.2d 342, 346 (10th Cir. 1986), *cert. denied*, 480 U.S. 947 (1987).

We first address plaintiffs' § 20(a) claim that Pring is liable as a controlling person of the issuer through his relationship with AmWest L.P. and AmWest. The district court applied the following two-part test for a controlling person: "(1) [defendant] actively participated in overall management and operation of the controlled entity and



(2) [defendant] actively participated, in some meaningful sense, in the fraud perpetrated by that entity." I R. tab 17 at 4 (citing *Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973) (en banc); *Harrison v. Enventure Capital Group, Inc.*, 666 F. Supp. 473, 478 (W.D.N.Y. 1987)). The district court held that Pring was not a controlling person because "plaintiffs' evidence fails to establish that Pring *actually participated in the alleged fraud* of the developer or the issuer of the [b]onds." *Id.* (emphasis added). Because it looked to plaintiffs' evidence, the district court clearly put the burden on plaintiffs to show that defendant actually participated in the alleged fraud.

We begin our analysis with the language of the statute. Section 20(a) of the Securities Exchange Act of 1934 provides:

Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78t(a). The statute first defines a controlling person as one "who, directly or indirectly, controls any person [who is] liable" for violations of the securities laws.<sup>9</sup> The final clause of the statute provides that even if

<sup>9</sup> In the regulations of the Securities and Exchange Commission (SEC) control is defined as "the possession, direct or

a person is a controlling person, he nevertheless is not liable if he "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." The statutory language clearly suggests a two-step analysis for § 20(a) liability: (1) determining whether the defendant is a controlling person; and (2) if so, determining whether the defendant nevertheless is entitled to the good-faith defense stated in the statute's final clause.

This court has addressed the definition of controlling person under § 20(a) in only one prior case. In *Richardson v. MacArthur*, 451 F.2d 35 (10th Cir. 1971), we stated that "[t]he statute is remedial and is to be construed liberally. It has been interpreted as requiring only some indirect means of discipline or influence short of actual direction to hold a 'controlling person liable.'" *Id.* at 41-42 (quoting *Myzel v. Fields*, 386 F.2d 718, 738 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968)). We went on to hold that an insurance company was a controlling person over an employee who handled virtually all of the company's business in one state. *Id.* at 42. Our conclusion in *Richardson* that one can be a controlling person despite exercising only *indirect* control follows the language of the statute.

indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." 17 C.F.R. § 230.405.



More recently this court addressed the controlling person provision of § 15 of the Securities Act of 1933,<sup>10</sup> 15 U.S.C. § 77o, in *San Francisco-Oklahoma Petroleum Exploration Corp. v. Carstan Oil Co.*, 765 F.2d 962 (10th Cir. 1985). Although § 15 and § 20(a) are not identical, the controlling person analysis is the same. *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1578 (9th Cir. 1990) (en banc), cert. denied, 111 S. Ct. 1621 (1991). In *Carstan Oil*, we said that a plaintiff had established a prima facie case of controlling person liability "when the [primary] violation was established, and when this defendant was shown to be a controlling person." 765 F.2d at 964. We stated that to be a controlling person one "need not have been involved in the particular transaction which became the subject of the litigation." *Id.* at 965. We also said that "[t]he defendant had the burden to demonstrate the" defense provided in the last clause of § 15. *Id.* at 964.

We believe that the allocation of the burdens for controlling person liability under § 20(a) should be the same as under § 15. A natural reading of both statutes is that a plaintiff's prima facie case consists of both a primary violation and "control" by the alleged controlling

<sup>10</sup> Section 15 provides:

Every person who . . . controls any person liable under sections 77k or 77l of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

15 U.S.C. § 77o.

person. The final clause of both statutes ("unless the controlling person . . ."), suggests that determining the defense should follow a finding that the defendant is a controlling person. Furthermore, circuit precedent is that the defendant has the burden to establish the defense under § 15, and like the Fifth Circuit "we are not aware of any reason the burden of proof should be different, especially since the sentence structure of the two statutes is similar." *G.A. Thompson & Co. v. Partridge*, 636 F.2d 945, 958 n.23 (5th Cir. 1981).

Placing the burden of establishing the defense on the defendant makes sense because "there would be little reason for the controlling person provision unless it differed in some meaningful ways from the standards for noncontrolling person liability." *Id.* A number of other circuits place the burden of establishing the defense on the defendant. *E.g.*, *Hollinger*, 914 F.2d at 1575 & n.25 (citing cases from the Second, Fifth, Sixth, Seventh and District of Columbia Circuits); *Metge v. Baehler*, 762 F.2d 621, 631 (8th Cir. 1985) ("good faith and lack of participation are affirmative defenses in a controlling person action"), cert. denied, 474 U.S. 1057, and cert. denied, 474 U.S. 1072 (1986). Thus, once a plaintiff establishes a primary violation and that the defendant is a controlling person under § 20(a), the defendant then has the burden to show that he "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." 15 U.S.C. § 78t(a).

Nowhere in the statute does it say that to be a controlling person a defendant must have actually participated in the primary violation. "[T]he statute premises liability solely on the control relationship, subject to the

good faith defense. According to the statutory language, once the plaintiff establishes that the defendant is a 'controlling person,' then the defendant bears the burden of proof to show his good faith." *Hollinger*, 914 F.2d at 1575.

Thus, the language of the statute causes us to reject those decisions that may be read to require a plaintiff to show the defendant actually or culpably participated in the primary violation. *See, e.g., Sharp v. Coopers & Lybrand*, 649 F.2d 175, 185 (3d Cir. 1981) (§ 20(a) requires "'culpable participation' in the securities violation"), *cert. denied*, 455 U.S. 938 (1982); *Carpenter v. Harris, Upham & Co.*, 594 F.2d 388, 394 (4th Cir.) (controlling person must "in some meaningful sense [be a] culpable participant[] in the acts perpetrated by the controlled person"), *cert. denied*, 444 U.S. 868 (1979); *Lanza v. Drexel & Co.*, 479 F.2d 1277, 1299 (2d Cir. 1973) (en banc) (same). Rather, the language of the statute leads us to join those circuits that hold that a plaintiff need not prove that the defendant actually or culpably participated in the primary violation. *E.g., Hollinger*, 914 F.2d at 1575 ("a plaintiff is *not* required to show 'culpable participation'"); *Metge*, 762 F.2d at 631 (rejecting the more restrictive culpable participation test); *G.A. Thompson & Co.*, 636 F.2d at 958 (the statute . . . [does not] require participation in the wrongful transaction"). This conclusion is consistent with this circuit's test for a controlling person under § 15. *See Carstan Oil*, 765 F.2d at 965.

Under this allocation of the burdens, the district court erred when it placed on plaintiffs the burden regarding defendant's actual participation in the primary violation. Actual participation in the primary violation is not part of plaintiffs' *prima facie* case under § 20(a); rather, nonparticipation in acts inducing or constituting

the primary violation, and good faith, are part of defendant's defense.

Applying the broad definition of control in the statute and the SEC regulation, we hold that the evidence viewed in the light most favorable to plaintiffs would support a finding by the trier of fact that Pring is a controlling person of the Authority for purposes of § 20(a). Pring was (1) a director of AmWest at all relevant times; (2) a vice-president of AmWest until February 1988; (3) the sole general partner of Pring Investments, Ltd., a twenty percent shareholder in AmWest; (4) with his wife, a thirty-five percent interest holder in AmWest L.P.; (5) with his wife, a \$5 million creditor of AmWest L.P.; and (6) with his wife, and as attorney-in-fact for others in his family, the owner and controller of the remaining land under the option agreement with AmWest L.P. These facts demonstrate that Pring was in a position of at least indirect control over AmWest and AmWest L.P. Because AmWest and AmWest L.P. controlled the Authority,<sup>11</sup> Pring's at least indirect control extended to the Authority.

Having determined that the evidence is sufficient to avoid summary judgment against plaintiffs on the issue whether Pring is a controlling person, the second step of the § 20(a) analysis is whether Pring can establish that he

<sup>11</sup> AmWest controlled AmWest L.P. as its sole general partner. AmWest's chairman of the board, AmWest's president, and another AmWest officer constituted the entire board of directors of the Authority and thus controlled it.



acted in good faith and did not participate in acts inducing the primary violation. We leave the determination of this question for the district court on remand.

### III

Next we address plaintiffs' aider-and-abettor claims against Pring and Central Bank under § 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. To establish aider-and-abettor liability a plaintiff must prove (1) the existence of a primary violation of the securities laws by another;<sup>12</sup> (2) knowledge of the primary violation by the alleged aider-and-abettor; and (3) substantial assistance by the alleged aider-and-abettor in achieving the primary violation. *Farlow v. Peat, Marwick, Mitchell & Co.*, 956 F.2d 982, 986 (10th Cir. 1992); *accord K&S Partnership v. Continental Bank, N.A.*, 952 F.2d 971, 977 (8th Cir. 1991), *petition for cert. filed*, 60 U.S.L.W. 3755 (U.S. Apr. 22, 1992) (No. 91-1692); *Schatz v. Rosenberg*, 943 F.2d 485, 495 (4th Cir. 1991), *cert. denied*, 112 S. Ct. 1475 (1992); *Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990).<sup>13</sup>

<sup>12</sup> Neither defendant argues that plaintiffs' evidence fails to establish a material question of fact as to the existence of a primary violation, which relieves us of further inquiry on the first element.

<sup>13</sup> Although the three elements seem to be universally accepted, some circuits state the second and third elements as a general awareness by the alleged aider-and-abettor that his or her role was part of an overall activity that was improper; and the alleged aider-and-abettor knowingly and substantially assisted the primary violation. *See Fine v. American Solar King Corp.*, 919 F.2d 290, 300 (5th Cir. 1990), *cert. dismissed*, 112 S. Ct. 576 (1991); *Schneberger v. Wheeler*, 859 F.2d 1477, 1480 (11th Cir.

### A

Pring's motion for summary judgment was granted by the district court on the ground that "silence and inaction are not bases to establish substantial assistance absent an additional fiduciary duty to disclose." I R. tab 17 at 5. Plaintiffs do not contend that Pring owed them a duty to disclose. Rather, plaintiffs argue that Pring's silence and inaction, in light of what he knew about AmWest and the appraisal,<sup>14</sup> did constitute substantial

1988), *cert. denied*, 490 U.S. 1091 (1989); *Moore v. Fenex, Inc.*, 809 F.2d 297, 303 (6th Cir.), *cert. denied*, 483 U.S. 1006 (1987); *Cleary v. Perfecttune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983); *Investors Research Corp. v. SEC*, 628 F.2d 168, 178 (D.C. Cir.), *cert. denied*, 449 U.S. 919 (1980). The Third Circuit has used both formulations. *Compare Landy v. FDIC*, 486 F.2d 139, 162-63 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974) with *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 799 (3d Cir.), *cert. denied*, 439 U.S. 930 (1978). The Seventh Circuit considers the three elements to be additional requirements beyond a showing that the alleged aider-and-abettor committed a proscribed "manipulative or deceptive" act with the same scienter as for primary liability. *See, e.g., Schliske v. Seafirst Corp.*, 866 F.2d 935, 947 (7th Cir. 1989). Although the Ninth Circuit generally states the elements as in the text, a recent case expressly includes in the second element the alleged aider-and-abettor's reckless disregard of the wrong and his or her role in furthering it. *See Levine v. Diamantheset, Inc.*, 950 F.2d 1478, 1483 (9th Cir. 1991).

<sup>14</sup> The record makes clear that Pring knew that AmWest needed to buy additional land to use as collateral. Pring's own admissions support plaintiffs' contentions that he was aware of concerns regarding the appraisal and that an independent review would be delayed until after the bonds were issued. *See* I R. tab 13, ex. A at 114-16. Pring does not challenge the existence of a material question of fact as to the second element of aider-and-abettor liability, i.e., scienter. However, regarding the third element of substantial assistance, we assume that Pring does



assistance because Pring had actual intent to aid the primary violation.

When there is no duty to disclose, it is sometimes stated absolutely that silence or inaction cannot be the basis for aider-and-abettor liability. *E.g.*, *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495-96 (7th Cir. 1986) ("When the nature of the offense is a failure to 'blow the whistle', the defendant must have a duty to blow the whistle."). The weight of authority, however, is that even absent a duty to disclose, silence and inaction can be substantial assistance for aider-and-abettor liability provided the defendant consciously intended to assist the primary violation. *E.g.*, *Schneberger v. Wheeler*, 859 F.2d 1477, 1480 (11th Cir. 1988), *cert. denied*, 490 U.S. 1091 (1989); *Moore v. Fenex, Inc.*, 809 F.2d 297, 303-04 (6th Cir.), *cert. denied*, 483 U.S. 1006 (1987); *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 800 (3d Cir.), *cert. denied*, 439 U.S. 930 (1978); *Woodward v. Metro Bank*, 522 F.2d 84, 97 (5th Cir. 1975). For example, in *Metge* the court said that

in the absence of a duty to act or disclose, an aider-abettor case predicated on inaction of the secondary party must meet a high standard of intent. As applied here, *Woodward* and *Monsen* require that the aider-abettor's inaction be accompanied by actual knowledge of the underlying fraud and intent to aid and abet a wrongful act. The requisite intent and knowledge may be shown by circumstantial evidence.

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controvert the existence of conscious intent to assist the primary violation.

762 F.2d at 625. In evaluating whether silence was accompanied by a conscious or actual intent to assist the primary violation, courts have examined whether the alleged aider-and-abettor benefitted from such silence. *See. e.g.*, *K&S Partnership*, 952 F.2d at 978; *Metge*, 762 F.2d at 629; *cf. DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir.) (on the issue of defendant's mental state, ask if "the defendant has thrown in his lot with the primary violators," *e.g.*, did defendant have anything to gain (quoting *Barker*, 797 F.2d at 497)), *cert. denied*, 111 S. Ct. 347 (1990); *Barker*, 797 F.2d at 497 ("If the plaintiff does not have direct evidence of scienter the court should ask whether the fraud (or cover-up) was in the interest of the defendants."). This analysis is appropriate in this case.

Plaintiffs' evidence establishes that Pring had a substantial personal stake in the 1988 bond issue. Pring knew that he and his family would receive a substantial payment from AmWest L.P. from the proceeds of the 1988 bond sale.<sup>15</sup> Based on the record, a jury could find that

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<sup>15</sup> The February 24, 1988 letter from Timm to Pring indicates AmWest's plan to use \$725,000 in "Funds available from the Bond Issue" to purchase land from the Pring family. I R. tab 13, ex. E at 3. In his deposition, Pring acknowledged a May 17, 1988 letter from Timm that included "[a] summary of the bond closing payments to the Pring shareholders and limited partners." I R. tab 13, ex. A at 130. Furthermore, in a letter dated June 15, 1988, the day before the bond closing, AmWest gave Pring "a detailed listing of the amounts which AmWest is arranging to remit to you from the proceeds of our June 16th bonds closing," which indicated a grand total payment of \$1,965,932.08. I R. tab 13, ex. I. Although Pring's answers were somewhat hedged on the question of where the funds came from, *see* I R. tab 13, ex. A at 136-38, he admitted that the

Pring had a strong motivation to stay silent despite what he knew. Pring's possible motivation is in sharp contrast to the lesser motivations courts have held insufficient to show conscious intent. *See, e.g., DiLeo*, 901 F.2d at 629 (accountant's fees for two years of audits); *National Union Fire Ins. Co. v. Turtur*, 892 F.2d 199, 207 (2d Cir. 1989) (insurance company's premium for a guarantee). Viewing the evidence in the light most favorable to plaintiffs, the nonmoving parties on summary judgment, the trier of fact reasonably could conclude that Pring had a conscious intent to assist the alleged primary violation and that had Pring not stayed silent plaintiffs would not have suffered losses. Thus, there was a genuine issue of material fact as to the third element of substantial assistance and summary judgment on plaintiff's aiding-and-abetting claim against Pring was inappropriate.

## B

Central Bank's motion for summary judgment was granted by the district court on the ground that plaintiffs failed to raise a genuine issue as to the element of scienter. The district court determined that plaintiffs had not established a duty to disclose by Central Bank. Then, citing only *National Union Fire Ins. Co. v. Eaton*, 701 F. Supp. 1031 (S.D.N.Y. 1988), the district court concluded that without a duty to disclose, recklessness does not satisfy the scienter requirement for aider-and-abettor liability.

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notation "Re-closing of 6/16/88" on the June 15 letter was in his handwriting, *id.* at 136, and the trier of fact could conclude that he in fact did know the source of funds was the 1988 bond issue.

Central Bank argues that recklessness is not sufficient scienter because it had no duty to disclose. Without such a duty, Central Bank asserts, the required scienter is conscious intent, citing *Woodward, Ross, Monsen, and IIT v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980). Central Bank argues that it did not have conscious intent to assist the primary violation, and that in any event it did not substantially assist the primary violation. Plaintiffs' primary argument is that even without a duty to disclose, recklessness is sufficient scienter. Plaintiffs contend that Central Bank acted recklessly by affirmatively agreeing to delay the independent review of the Hastings updated appraisal. Plaintiffs also assert that Central Bank did provide substantial assistance to the primary violation.

We agree with Central Bank's argument and the district court's conclusion that Central Bank owed plaintiffs no duty to disclose. An indenture trustee's duties are strictly defined and limited to the terms of the indenture. *See, e.g., Elliott Assocs. v. J. Henry Schroder Bank & Trust Co.*, 838 F.2d 66, 71 (2d Cir. 1988). The Trust Indenture Act of 1939 expressly provides that "the indenture trustee shall not be liable except for the performance of such duties as are specifically set out in such indenture." 15 U.S.C. § 7700(a)(1). Section 9.01(a) of the indenture at issue here provided that the trustee at relevant times "undertakes to perform such duties and only such duties as are specifically set forth in this [i]ndenture." II Supp. R. 53.

But the lack of a duty to disclose is not dispositive in this case. As Central Bank concedes, the Trust Indenture Act of 1939 "does not affect 'the rights, obligations, duties [, or] liabilities of any person' under the federal securities



laws." Answer Brief of Defendant-Appellee Central Bank at 29 (quoting 15 U.S.C. § 77zzz). It is clear that in a proper case it is possible for an indenture trustee to be held liable as an aider-and-abettor. See *Cronin*, 619 F.2d at 861-862 (reversing grant of summary judgment for defendant indenture trustees and remanding for further discovery despite the district court's belief "that the [trustees'] duties were limited by the terms of their indenture agreements"); *Lewis v. Marine Midland Grace Trust Co.*, 63 F.R.D. 39, 45-46 (S.D.N.Y. 1973) (denying defendants' motions to dismiss and indicating that if the elements of aiding-and-abetting liability are established the defendant indenture trustee can be liable); cf. *Ross v. Bank South, N.A.*, 837 F.2d 980, 1003 (11th Cir.) (implying that an indenture trustee could be liable if plaintiffs had evidence, as opposed to just conclusory allegations, that the trustee had knowledge of the fraud), *vacated*, 848 F.2d 1132 (11th Cir. 1988), *on reh'g*, 885 F.2d 723 (11th Cir. 1989) (en banc), *cert. denied*, 495 U.S. 905 (1990). Thus, Central Bank is not immune from liability if plaintiffs can prove the elements of aider-and-abettor liability.

The established rule is that recklessness is sufficient scienter for a primary violation of § 10(b) and Rule 10b-5. E.g., *Hackbart v. Holmes*, 675 F.2d 1114, 1117 (10th Cir. 1982); accord, e.g., *Van Dyke v. Coburn Enters., Inc.*, 873 F.2d 1094, 1100 (8th Cir. 1989) ("[t]he majority rule in the Courts of Appeals is that recklessness satisfies th[e] scienter requirement"; citing cases from the Second, Third, Fifth, Seventh, Ninth, Eleventh and District of Columbia

Circuits).<sup>16</sup> The Seventh Circuit has said that aiding-and-abetting liability requires "the same mental state [as] required for primary liability." *Barker*, 797 F.2d at 495. This circuit, in at least three cases involving claims of both primary and aiding-and-abetting liability, has indicated that recklessness is sufficient scienter without distinguishing between the claims. See *C.E. Carlson, Inc. v. SEC*, 859 F.2d 1429, 1435 (10th Cir. 1988); *Cronin v. Midwestern Okla. Dev. Auth.*, 619 F.2d 856, 862 (10th Cir. 1980); *Edward J. Mawod & Co. v. SEC*, 591 F.2d 588, 595-96 (10th Cir. 1979).

Several courts expressly have held that recklessness satisfies the scienter requirement for aiding-and-abetting liability. See, e.g., *Levine v. Diamantheset, Inc.*, 950 F.2d 1478, 1483 (9th Cir. 1991) (including recklessness in the scienter element and citing cases); *FDIC v. First Interstate Bank*, 885 F.2d 423, 432-33 (8th Cir. 1989) (holding recklessness sufficient in a case predicated on action); *Dirks v. SEC*, 681 F.2d 824, 844-45 (D.C. Cir. 1982) (opinion of Wright, J.) (Two leading aiding-and-abetting cases "do not imply that 'knowingly \* \* \* assist' or 'general awareness' require a higher standard for aiding or abetting liability than the general scienter standard required by *Ernst & Ernst*. Recklessness would have been enough." (footnote omitted)), *rev'd on other grounds*, 463 U.S. 646 (1983). This court has said that "a proper showing of

<sup>16</sup> Recklessness satisfied the scienter requirement for common law fraud. See, e.g., *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1024 (6th Cir. 1979). Although negligence is not sufficient, the Supreme Court has left open the question of whether recklessness is sufficient scienter for a violation of § 10(b). *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 & n.12 (1976).



reckless conduct *might* satisfy [the] state of mind requirement" for aiding-and-abetting liability. *Decker v. SEC*, 631 F.2d 1380, 1388 & n.16 (10th Cir. 1980) (aiding-and-abetting claim under 15 U.S.C. § 17(e)(1)) (emphasis added).

Some courts, however, have indicated that recklessness is not sufficient scienter for aiding-and-abetting liability unless the defendant had a fiduciary duty. See, e.g., *Edwards & Hanly v. Wells Fargo Sec. Clearance Corp.*, 602 F.2d 478, 484 (2d Cir. 1979) ("We have not used the 'recklessness' standard when money damages are claimed in an aiding and abetting context, except on the basis of a breach of fiduciary duty."), *cert. denied*, 444 U.S. 1045 (1980)<sup>17</sup>. See generally William H. Kuehnle, *Secondary Liability Under the Federal Securities Laws - Aiding and Abetting, Conspiracy, Controlling Person, and Agency: Common-Law Principles and the Statutory Scheme*, 14 J. Corp. L. 313, 327-30 (1989) (stating that while some courts have adopted recklessness as a general standard for aiding-and-abetting liability, many courts use a recklessness standard only in certain circumstances, including where there is a fiduciary duty); Don J. McDermott, Jr., Note, *Liability for Aiding and Abetting Violations of Rule 10b-5: The Recklessness Standard in Civil Damage Actions*, 62 Tex. L. Rev. 1087, 1103-08 (1984) (same, finding the fiduciary duty requirement particularly clear in the Second Circuit,

<sup>17</sup> We have quoted language from the Second Circuit that even if a defendant is reckless, "absent a fiduciary duty owing from [defendant] to [plaintiff] there is no aiding and abetting liability." *Farlow*, 956 F.2d at 987 (quoting *Ross*, 904 F.2d at 824). This quotation, however, was made during the course of a lengthy discussion of various cases, and *Farlow* did not adopt this view as the law of this circuit.

but indicating that some Second Circuit opinions have either hesitated to accept the requirement or have gone to great lengths to find some duty).

In this case Central Bank has mischaracterized plaintiffs' claim as one alleging that Central Bank improperly did not disclose certain facts. It is true that the primary violation alleged by plaintiffs includes the nondisclosure in the official statement of certain facts. It is also true that plaintiffs' aiding-and-abetting claim against Pring is based on the allegation that his silence and nondisclosure assisted the primary violation. But plaintiffs' claim against Central Bank is different. Plaintiffs allege that Central Bank assisted the primary violation by *affirmative action*, specifically by affirmatively agreeing to delay the independent review of the Hastings appraisal.<sup>18</sup>

Thus we arrive at the issue before us: when an alleged aider-and-abettor owes no duty to plaintiffs, but takes affirmative action that assists the primary violation,

<sup>18</sup> In the district court plaintiffs argued that Central Bank both affirmatively acted to delay the independent review of the Hastings appraisal and failed to alert plaintiffs of the risks related to the Hastings appraisal. I R. tab 1 at 13-14 (complaint); I R. tab 12 at 1 (brief opposing motion for summary judgment (emphasizing "affirmative steps")). The district court's order only deals with plaintiffs' claim of affirmative acts. Furthermore, on appeal, plaintiffs appear to have abandoned the argument that Central Bank improperly was silent. See Reply Brief for the Plaintiffs-Appellants at 23 ("Central characterizes plaintiffs' showing as nothing more than an argument that Central passively failed to 'blow the whistle' on the Hastings appraisal. Central says it did not have a duty to be a whistle blower. But this is distinctly not plaintiffs' argument.").

does recklessness satisfy the scienter requirement for aiding-and-abetting liability? In light of the affirmative nature of Central Bank's alleged assistance, the non-disclosure cases relied on by Central Bank are inapposite. Central Bank asserts that "[t]here is simply no decision in this Circuit or any other which imposes aider and abettor liability upon a finding of recklessness where there is not also a breach of a duty to disclose." Answer Brief of Defendant-Appellee Central Bank at 22. However, such cases do exist, and they are the ones that are relevant here.

The Ninth Circuit's recent opinion in *Levine* is particularly enlightening. In that case the court addressed the potential liability of a trust company and a bank as aiders-and-abettors of an allegedly fraudulent diamond investment scheme. 950 F.2d at 1483-85. The trust company allegedly assisted the primary violation by, inter alia, allowing its name to be used in promotional materials, accepting telephone inquiries from investors, and issuing confirmations to investors. *Id.* at 1484. The bank allegedly assisted the primary violation by, inter alia, sending an officer to certain seminars, coordinating the handling of investor inquiries, making certain representations to investors, and considering but apparently not making an amendment to a deposit agreement to conform to certain representations. *Id.* at 1485. Of course, the facts in the instant case are different. Importantly, however, the *Levine* court considered the case before it as one based on assistance by action and for that reason expressly found irrelevant the question whether the alleged aiders-and-abettors had a duty to disclose. *See id.* at 1484-85 nn.4-5.

Further, in holding that the plaintiff's allegations adequately stated claims for aiding-and-abetting liability, the court applied a recklessness standard. *See id.* at 1484 (the trust company's actions "may well have been reckless – that is, highly unreasonable and constituting an extreme departure from standards of ordinary care"); *id.* at 1485 (plaintiff "could prove facts indicating [the bank's] reckless disregard, if not actual knowledge, of both [the primary violations] and the bank's role in the violations").

The Eighth Circuit also has applied a recklessness standard in an aiding-and-abetting case the court described as one "predicated on action." *First Interstate Bank*, 885 F.2d at 429, 432-33 (applying *Metge*, 762 F.2d at 621, to a case of common law aiding-and-abetting). In *First Interstate Bank*, despite various warnings and significant concerns about a particular customer, the defendant bank assisted the customer's fraud by processing accounts, handling wire transfers, and reversing a decision to require the customer to close his accounts. *See id.* at 424-28. The jury found the bank liable as an aider-and-abettor. *See id.* at 428. In affirming the denial of a motion for judgment n.o.v., the court said the "evidence supports an inference that [the defendant bank], with potential profits in mind, recklessly chose to continue its relationship with [the primary violator]." *Id.* at 432. The defendant bank made the argument – essentially the same argument put forth by Central Bank – that it had no fiduciary duty and therefore it could not be held liable for inaction without a showing of more than recklessness. *See id.* at 432-33. The Eighth Circuit rejected this argument, noting that this was "a case predicated on action" and stating that "[i]t need not be shown, therefore, that [the



defendant bank] consciously intended to defraud the [plaintiff]." *Id.* at 433.

The cases discussed above reject the idea that the scienter element for aiding-and-abetting liability cannot be satisfied by recklessness without a duty to disclose. We also reject that view. We hold that in an aiding-and-abetting case based on assistance by action, the scienter element is satisfied by recklessness.

"[R]eckless behavior is conduct that is 'an extreme departure from the standards of ordinary care, and which presents a danger . . . that is either known to the defendant or is so obvious that the actor must have been aware of it.'" *Hackbart*, 675 F.2d at 1118 (citation omitted); accord, e.g., *Hollinger*, 914 F.2d at 1569. We turn to the facts of this case, viewed in the light most favorable to plaintiffs, to determine whether the trier of fact reasonably could conclude that Central Bank was reckless when it agreed to delay the independent review of the Hastings updated appraisal.

Central Bank appears to argue that this was simply a "transaction[] constituting the daily grist of the mill." *Woodward*, 522 F.2d at 97. But the evidence supports the inference that this was not an ordinary transaction. Central Bank's own trust officer and others characterized this as a complicated transaction. See I R. tab 12, ex. G at 454; I R. tab 12, ex. B at 161. Central Bank's in-house appraiser indicated that this was the only situation in which he had been asked to review an appraisal of collateral for a bond issue. See I R. tab 12, ex. J at 46. Before the agreement to delay the independent review, one of Central Bank's vice-presidents assumed responsibility for the transaction

from the trust officer who had been handling it. See I R. tab 12, ex. B at 161. Nothing in the record suggests that in any other situation had Central Bank first decided to require an independent review of an appraisal for a bond issue and later agreed to delay it.

Central Bank argues that the agreement to delay the independent review was justified in part because it was entitled to rely on the certifications provided by the Authority and Hastings. The indenture does contain provisions to that effect. But the issue is whether agreeing to delay the independent review was an extreme departure from the standards of ordinary care that carried a known or obvious danger, not whether it was a breach of authority under the indenture. As to Central Bank's reliance on the Authority's certifications, it is significant that Central Bank previously had been warned expressly that the Authority may have "given false or misleading certifications." I R. tab 12, ex. G at 455. As to Hastings's certification, the fact that Central Bank apparently prepared a draft of it, see II Supp. R. tab 75, and it was not executed until June 16 (the date of the bond closing), suggest that it was given little weight in Central Bank's decision to agree to delay the independent review.

Before the agreement to delay the independent review, it is undisputed that Central Bank knew that serious concerns had been raised about the accuracy of the Hastings updated appraisal. Central Bank's own action, in originally requiring an independent review, demonstrates that it believed that those concerns were credible. As a condition to postponing the independent review of the Hastings updated appraisal, Central Bank



did require that approximately \$2 million worth of additional property be added to the security for the 1986 bond issue. This may have alleviated concerns about insufficient security for the 1986 bonds, but it did nothing to address the danger that the collateral was deficient for the 1988 bonds. Although the bank's duty at that time was only with respect to the 1986 bond issue, the bank was preparing to be the indenture trustee for the 1988 bond issue. Central Bank knew that the sale of the 1988 bonds was imminent, and apparently knew that the Hastings updated appraisal was being relied on to value the collateral for the 1988 bonds. Under these circumstances, the bank's knowledge of the alleged inadequacies of the Hastings updated appraisal could support a finding of extreme departure from the standards of ordinary care.

The above are all of the facts we can discern from the record before the court for summary judgment. Although a trial might shed more light on the reasons for Central Bank's actions, and that might justify the bank's exoneration, on the basis of the record before us we hold that plaintiffs have established a genuine issue of material fact as to the scienter element of aiding-and-abetting liability.<sup>19</sup>

The third element of substantial assistance was not addressed by the district court.<sup>20</sup> Plaintiffs argue that

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<sup>19</sup> In addition to arguing that Central Bank was reckless, plaintiffs argue alternatively that Central Bank had actual knowledge of the primary violation. Because of our disposition, we need not reach this issue.

<sup>20</sup> Central Bank argues that plaintiffs "absolutely ignored" the element of substantial assistance in the district court.

Central Bank's agreement to delay an independent review of the Hastings appraisal constituted substantial assistance to the primary violation. Central Bank argues that although it had the *right* to require an independent review it was not required to do so under the indenture. This simply establishes that Central Bank did not breach a duty under the indenture. On the separate question of whether Central Bank rendered substantial assistance to the primary violation, which allegedly included representing the Hastings appraisal as accurate, the trier of fact reasonably could conclude that had Central Bank adhered to its original demand for an independent review and not agreed to delay it, the depleted collateral would have been discovered and plaintiffs' losses avoided. Thus, we hold that plaintiffs have raised a genuine issue of material fact as to the element of substantial assistance, and the district court's grant of summary judgment for Central Bank was inappropriate.

REVERSED and REMANDED for proceedings consistent herewith.

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Although plaintiffs' brief opposing summary judgment focused on the scienter element it cited the substantial assistance element and specifically referred to the agreement to delay the independent review of the appraisal. Any suggestion that plaintiffs failed to preserve the substantial assistance issue is without merit.

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STETSON HILLS PUBLIC BUILDING AUTHORITY  
ASSESSMENT LIEN BONDS  
DEBT SERVICE SCHEDULE

DATED DATE: 12/01/86  
DELIVERY DATE: 12/11/86

DATE	PRINCIPAL	RATE	INTEREST	TOTAL	FISCAL TOTAL
06/30/87			760,382.64	760,382.64	
12/30/87			654,875.00	654,875.00	1,415,257.64
06/30/88			654,875.00	654,875.00	
12/30/88	150,000.00	6.500	654,875.00	804,875.00	1,459,750.00
06/30/89			650,000.00	650,000.00	
12/30/89	200,000.00	6.750	650,000.00	850,000.00	1,500,000.00
06/30/90			643,250.00	643,250.00	
12/30/90	250,000.00	7.000	643,250.00	893,250.00	1,536,500.00
06/30/91			634,500.00	634,500.00	
12/30/91	300,000.00	7.200	634,500.00	934,500.00	1,569,000.00
06/30/92			623,700.00	623,700.00	
12/30/92	350,000.00	7.400	623,700.00	973,700.00	1,597,400.00
06/30/93			610,750.00	610,750.00	
12/30/93	400,000.00	7.600	610,750.00	1,010,750.00	1,621,500.00
06/30/94			595,550.00	595,550.00	
12/30/94	450,000.00	7.800	595,550.00	1,045,550.00	1,641,100.00
06/30/95			578,000.00	578,000.00	
12/30/95	500,000.00	8.000	578,000.00	1,078,000.00	1,656,000.00
06/30/96			558,000.00	558,000.00	
12/30/96			558,000.00	558,000.00	1,116,000.00
06/30/97			558,000.00	558,000.00	
12/30/97			558,000.00	558,000.00	1,116,000.00
06/30/98			558,000.00	558,000.00	
12/30/98			558,000.00	558,000.00	1,116,000.00
06/30/99			558,000.00	558,000.00	
12/30/99	1,505,000.00	9.000	558,000.00	2,063,000.00	2,621,000.00
06/30/00			490,275.00	490,275.00	
12/30/00	1,635,000.00	9.000	490,275.00	2,125,275.00	2,615,550.00
06/30/01			416,700.00	416,700.00	
12/30/01	1,790,000.00	9.000	416,700.00	2,206,700.00	2,623,400.00
06/30/02			336,150.00	336,150.00	
12/30/02	930,000.00	9.000	336,150.00	1,266,150.00	1,602,300.00
06/30/03			294,300.00	294,300.00	
12/30/03	2,030,000.00	9.000	294,300.00	2,324,300.00	2,618,600.00
06/30/04			202,950.00	202,950.00	
12/30/04	310,000.00	9.000	202,950.00	512,950.00	715,900.00
06/30/05			189,000.00	189,000.00	
12/30/05	1,075,000.00	9.000	189,000.00	1,264,000.00	1,453,000.00
06/30/06			140,625.00	140,625.00	
12/30/06	3,125,000.00	9.000	140,625.00	3,265,625.00	3,406,250.00
TOTAL	15,000,000.00		20,000,507.64	35,000,507.64	
ACCRUED			36,381.94	36,381.94	
NET COST	15,000,000.00		19,964,125.70	34,964,125.70	

AVERAGE COUPON  
TIC  
BOND YEARS  
AVERAGE LIFE  
NIC  
DISCOUNT

8.89700  
9.35266 (FROM DELIVERY DATE)  
224,808.33333 (FROM DATED DATE)  
14.95964  
9.15469 (FROM DATED DATE)  
580,000.00

+ SINKING FUND



ASSUMPTION TABLE & SUMMARY OF SELECTED AMOUNTS

## ASSUMPTIONS

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ISSUER NAME: STETSON HILLS PUBLIC BUILDING AUTHORITY

SAVEFILE NAME: STET-88

INITIAL RES. (R-1-6000) ASSESSMENT: \$20,455.00

\* \* \*

ASSESSMENT ESCALATION RATE: 9.2500%

BOND RESERVE FUND INTEREST RATE: 6.5000%

\* \* \*

BOND PAR AMOUNT: \$15,000,000

ANNUAL TRUSTEE FEE: \$20,000

\* \* \*

PROJECT SETTLEMENT DATE: 12/01/86

BOND DATED DATE: 12/01/86

FIRST BOND INTEREST DATE: 06/30/87

LAST BOND MATURITY DATE: 12/30/2006

YEAR END: 12/30

\* \* \*

INTEREST PERIOD (in months): 6

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## SELECTED RESULTS

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FINAL BOND FUND: \$15,000,000

SH PREPAYMENTS: \$0

SUPPLEMENTARY CONST FUND PROCEEDS: (\$11,589,297)

BOND YIELD (True Int. Cost): 8.851519959%

NET INTEREST COST: 8.896693171%

	PERCENT OF	DOLLAR
	PAR ISSUED	AMOUNT

.....

CONSTRUCTION PROCEEDS: 85.7316% \$12,859,742 12.864.742

UNDERWRITER DISCOUNT: 3.5000% ~~525,000~~ 580.000

ORIGINAL ISSUE DISCOUNT: 0.0000% 0

RESERVE REQUIREMENT: 9.4351% 1,415,258

CAPITALIZED INTEREST: 0.0000% 0

COST OF ISSUANCE: 1.3333% 200,000

ACCRUED INTEREST: 0.0000% 0

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TOTAL PAR ISSUED: 100.0000% \$15,000,000

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Year	Non-Residential (P.I.P.)					Non-Residential (P.B.C.)					Total Non-	
	Acres Sold	Less: Acres Prepaid	Net Acres Sold	Assessment Rate	Assessment Due	Acres Sold	Less: Acres Prepaid	Net Acres Sold	Assessment Rate	Assessment Due	Resid. Asmt. Due	
12/01/86												
06/30/87	10.550	0.000	10.550	\$74,865	\$789,829	2.350	0.000	2.350	\$122,116	\$286,973	\$1,076,802	
12/30/87	10.550	0.000	10.550	74,865	789,829	2.350	0.000	2.350	122,116	286,973	1,076,802	
06/30/88	7.200	0.000	7.200	81,790	588,890	1.600	0.000	1.600	133,412	213,459	802,350	
12/30/88	7.200	0.000	7.200	81,790	588,890	1.600	0.000	1.600	133,412	213,459	802,350	
06/30/89	4.800	0.000	4.800	89,356	428,909	1.050	0.000	1.050	145,753	153,040	581,949	
12/30/89	4.800	0.000	4.800	89,356	428,909	1.050	0.000	1.050	145,753	153,040	581,949	
06/30/90	3.450	0.000	3.450	97,621	336,794	0.750	0.000	0.750	159,235	119,426	456,220	
12/30/90	3.450	0.000	3.450	97,621	336,794	0.750	0.000	0.750	159,235	119,426	456,220	
06/30/91	1.500	0.000	1.500	106,651	159,977	0.350	0.000	0.350	173,964	60,887	220,864	
12/30/91	1.500	0.000	1.500	106,651	159,977	0.350	0.000	0.350	173,964	60,887	220,864	
06/30/92	3.490	0.000	3.490	116,517	406,643	1.700	0.000	1.700	190,056	323,095	729,738	
12/30/92	3.490	0.000	3.490	116,517	406,643	1.700	0.000	1.700	190,056	323,095	729,738	
06/30/93		0.000	0.000	127,294	0	2.450	0.000	2.450	207,636	508,708	508,708	
12/30/93		0.000	0.000	127,294	0	2.450	0.000	2.450	207,636	508,708	508,708	
06/30/94		0.000	0.000	139,069	0	3.000	0.000	3.000	226,842	680,527	680,527	
12/30/94		0.000	0.000	139,069	0	3.000	0.000	3.000	226,842	680,527	680,527	
06/30/95		0.000	0.000	151,933	0	2.100	0.000	2.100	247,825	520,433	520,433	
12/30/95		0.000	0.000	151,933	0	2.100	0.000	2.100	247,825	520,433	520,433	
06/30/96		0.000	0.000	165,987	0	1.100	0.000	1.100	270,749	297,824	297,824	
12/30/96		0.000	0.000	165,987	0	1.100	0.000	1.100	270,749	297,824	297,824	
06/30/97		0.000	0.000	181,341	0	0.500	0.000	0.500	295,793	147,897	147,897	
12/30/97		0.000	0.000	181,341	0	0.500	0.000	0.500	295,793	147,897	147,897	
06/30/98		0.000	0.000	198,115	0	2.000	0.000	2.000	323,154	646,308	646,308	
12/30/98		0.000	0.000	198,115	0	2.000	0.000	2.000	323,154	646,308	646,308	
06/30/99		0.000	0.000	216,440	0	2.500	0.000	2.500	353,046	882,615	882,615	
12/30/99		0.000	0.000	216,440	0	2.500	0.000	2.500	353,046	882,615	882,615	
06/30/2000		0.000	0.000	236,461	0	3.000	0.000	3.000	385,703	1,157,108	1,157,108	
12/30/2000		0.000	0.000	236,461	0	3.000	0.000	3.000	385,703	1,157,108	1,157,108	
06/30/2001		0.000	0.000	258,334	0	2.350	0.000	2.350	421,380	990,243	990,243	
12/30/2001		0.000	0.000	258,334	0	2.350	0.000	2.350	421,380	990,243	990,243	
06/30/2002		0.000	0.000	282,229	0	1.250	0.000	1.250	460,358	575,447	575,447	
12/30/2002			0.000	282,229	0	1.250		1.250	460,358	575,447	575,447	
06/30/2003			0.000	308,336	0	0.650		0.650	502,941	326,912	326,912	
12/30/2003			0.000	308,336	0	0.650		0.650	502,941	326,912	326,912	
06/30/2004			0.000	336,857	0	1.550		1.550	549,463	851,668	851,668	
12/30/2004			0.000	336,857	0	1.550		1.550	549,463	851,668	851,668	
06/30/2005			0.000	368,016	0	2.350		2.350	600,288	1,410,677	1,410,677	
12/30/2005			0.000	368,016	0	2.350		2.350	600,288	1,410,677	1,410,677	
06/30/2006			0.000	402,057	0	1.205		1.205	655,815	790,257	790,257	
12/30/2006			0.000	402,057	0	1.205		1.205	655,815	790,257	790,257	
	61.980	0.000	61.980		\$5,422,083	67.610	0.000	67.610		\$21,887,009	\$27,309,092	



Single-Family Residential (R-1-6000) -----//						Multi-Family Residential (P.U.D.) -----/						Total	Total
Year	Acres Sold	Less: Acres Prepaid	Net Acres Sold	Assessment Rate	Assessment Due	Acres Sold	Less: Acres Prepaid	Net Acres Sold	Assessment Rate	Assessment Due	Assessment Due	Resid. Asmt. Due	Assessment Due
12/01/86													
06/30/87	15.950	0.000	15.950	\$20,455	\$326,257	14.750	0.000	14.750	\$29,660	\$437,481	\$763,739		\$1,840,541
12/30/87	15.950	0.000	15.950	20,455	326,257	14.750	0.000	14.750	29,660	437,481	763,739		1,840,541
06/30/88	11.105	0.000	11.105	22,347	248,164	18.430	0.000	18.430	32,403	597,192	845,357		1,647,707
12/30/88	11.105	0.000	11.105	22,347	248,164	18.430	0.000	18.430	32,403	597,192	845,357		1,647,707
06/30/89		0.000	0.000	24,414	0		0.000	0.000	35,401	0	0		581,949
12/30/89		0.000	0.000	24,414	0		0.000	0.000	35,401	0	0		581,949
06/30/90		0.000	0.000	26,673	0		0.000	0.000	38,675	0	0		456,220
12/30/90		0.000	0.000	26,673	0		0.000	0.000	38,675	0	0		456,220
06/30/91		0.000	0.000	29,140	0		0.000	0.000	42,253	0	0		220,864
12/30/91		0.000	0.000	29,140	0		0.000	0.000	42,253	0	0		220,864
06/30/92		0.000	0.000	31,835	0		0.000	0.000	46,161	0	0		729,738
12/30/92		0.000	0.000	31,835	0		0.000	0.000	46,161	0	0		729,738
06/30/93		0.000	0.000	34,780	0		0.000	0.000	50,431	0	0		508,708
12/30/93		0.000	0.000	34,780	0		0.000	0.000	50,431	0	0		508,708
06/30/94		0.000	0.000	37,997	0		0.000	0.000	55,096	0	0		680,527
12/30/94		0.000	0.000	37,997	0		0.000	0.000	55,096	0	0		680,527
06/30/95		0.000	0.000	41,512	0		0.000	0.000	60,192	0	0		520,433
12/30/95		0.000	0.000	41,512	0		0.000	0.000	60,192	0	0		520,433
06/30/96		0.000	0.000	45,352	0		0.000	0.000	65,760	0	0		297,824
12/30/96		0.000	0.000	45,352	0		0.000	0.000	65,760	0	0		297,824
06/30/97		0.000	0.000	49,547	0		0.000	0.000	71,843	0	0		147,897
12/30/97		0.000	0.000	49,547	0		0.000	0.000	71,843	0	0		147,897
06/30/98		0.000	0.000	54,130	0		0.000	0.000	78,488	0	0		646,308
12/30/98		0.000	0.000	54,130	0		0.000	0.000	78,488	0	0		646,308
06/30/99		0.000	0.000	59,137	0		0.000	0.000	85,748	0	0		882,615
12/30/99		0.000	0.000	59,137	0		0.000	0.000	85,748	0	0		882,615
06/30/2000		0.000	0.000	64,607	0		0.000	0.000	93,680	0	0		1,157,108
12/30/2000		0.000	0.000	64,607	0		0.000	0.000	93,680	0	0		1,157,108
06/30/2001		0.000	0.000	70,583	0		0.000	0.000	102,345	0	0		990,243
12/30/2001		0.000	0.000	70,583	0		0.000	0.000	102,345	0	0		990,243
06/30/2002		0.000	0.000	77,112	0		0.000	0.000	111,812	0	0		575,447
12/30/2002			0.000	77,112	0			0.000	111,812	0	0		575,447
06/30/2003			0.000	84,245	0			0.000	122,155	0	0		326,912
12/30/2003			0.000	84,245	0			0.000	122,155	0	0		326,912
06/30/2004			0.000	92,037	0			0.000	133,454	0	0		851,668
12/30/2004			0.000	92,037	0			0.000	133,454	0	0		851,668
06/30/2005			0.000	100,551	0			0.000	145,799	0	0		1,410,677
12/30/2005			0.000	100,551	0			0.000	145,799	0	0		1,410,677
06/30/2006			0.000	109,852	0			0.000	159,285	0	0		790,257
12/30/2006			0.000	109,852	0			0.000	159,285	0	0		790,257
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54.110						66.360						\$30,527,283	
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DCCASO



DEBT SERVICE SCHEDULE

Year	Principal	Coupon Rate	Interest	Payment Due	Fiscal Total	Bond Fund Balance	Reserve Requirement
12/01/86						\$15,000,000	\$1,415,258
06/30/87			\$760,382.64	\$760,382.64		15,000,000	1,415,258
12/30/87	0		654,875.00	654,875.00	1,415,257.64	15,000,000	1,459,750
06/30/88	0		654,875.00	654,875.00		15,000,000	1,459,750
12/30/88	150,000	6.500%	654,875.00	804,875.00	1,459,750.00	14,850,000	1,500,000
06/30/89	0		650,000.00	650,000.00		14,850,000	1,500,000
12/30/89	200,000	6.750%	650,000.00	850,000.00	1,500,000.00	14,650,000	1,536,500
06/30/90	0		643,250.00	643,250.00		14,650,000	1,536,500
12/30/90	250,000	7.000%	643,250.00	893,250.00	1,536,500.00	14,400,000	1,569,000
06/30/91	0		634,500.00	634,500.00		14,400,000	1,569,000
12/30/91	300,000	7.200%	634,500.00	934,500.00	1,569,000.00	14,100,000	1,597,400
06/30/92	0		623,700.00	623,700.00		14,100,000	1,597,400
12/30/92	350,000	7.400%	623,700.00	973,700.00	1,597,400.00	13,750,000	1,621,500
06/30/93	0		610,750.00	610,750.00		13,750,000	1,621,500
12/30/93	400,000	7.600%	610,750.00	1,010,750.00	1,621,500.00	13,350,000	1,641,100
06/30/94	0		595,550.00	595,550.00		13,350,000	1,641,100
12/30/94	450,000	7.800%	595,550.00	1,045,550.00	1,641,100.00	12,900,000	1,656,000
06/30/95	0		578,000.00	578,000.00		12,900,000	1,656,000
12/30/95	500,000	8.000%	578,000.00	1,078,000.00	1,656,000.00	12,400,000	1,116,000
06/30/96	0		558,000.00	558,000.00		12,400,000	1,116,000
12/30/96	0		558,000.00	558,000.00	1,116,000.00	12,400,000	1,116,000
06/30/97	0		558,000.00	558,000.00		12,400,000	1,116,000
12/30/97	0		558,000.00	558,000.00		12,400,000	1,116,000
06/30/98	0		558,000.00	558,000.00	1,116,000.00	12,400,000	1,116,000
12/30/98	0		558,000.00	558,000.00		12,400,000	1,116,000
06/30/99	0		558,000.00	558,000.00	1,116,000.00	12,400,000	2,621,000
12/30/99	1,505,000	9.000%	558,000.00	2,063,000.00	2,621,000.00	10,895,000	2,615,550
06/30/2000	0		490,275.00	490,275.00		10,895,000	2,615,550
12/30/2000	1,635,000	9.000%	490,275.00	2,125,275.00	2,615,550.00	9,260,000	2,623,400
06/30/2001	0		416,700.00	416,700.00		9,260,000	2,623,400
12/30/2001	1,790,000	9.000%	416,700.00	2,206,700.00	2,623,400.00	7,470,000	1,602,300
06/30/2002	0		336,150.00	336,150.00		7,470,000	1,602,300
12/30/2002	930,000	9.000%	336,150.00	1,266,150.00	1,602,300.00	6,540,000	2,618,600
06/30/2003	0		294,300.00	294,300.00		6,540,000	2,618,600
12/30/2003	2,030,000	9.000%	294,300.00	2,324,300.00	2,618,600.00	4,510,000	715,900
06/30/2004	0		202,950.00	202,950.00		4,510,000	715,900
12/30/2004	310,000	9.000%	202,950.00	512,950.00	715,900.00	4,200,000	1,453,000
06/30/2005	0		189,000.00	189,000.00		4,200,000	1,453,000
12/30/2005	1,075,000	9.000%	189,000.00	1,264,000.00	1,453,000.00	3,125,000	3,406,250
06/30/2006	0		140,625.00	140,625.00		3,125,000	3,406,250
12/30/2006	3,125,000	9.000%	140,625.00	3,265,625.00	3,406,250.00	0	0
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\$15,000,000			\$20,000,507.64	\$35,000,507.64			
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## STETSON HILLS PUBLIC BUILDING AUTHORITY

Project Analysis (Collateral Only)

## CASH FLOW

Year	Assessments Paid In	Paid Out Debt Service	Paid Out Expenses	Paid In From Issue	Funds From Restr. Suppl. Const. Fund	Prepaid Assmnts/SH	Interest Earned	Balance	Balance Less Res Req
2/01/86				\$1,415,258	0	0		1,415,258	0
6/30/87	\$1,840,541	(\$760,383)	\$0		0	0	53,179	2,548,595	1,133,337
12/30/87	1,840,541	(654,875)	(20,000)		0	0	83,056	3,797,317	2,337,567
6/30/88	1,647,707	(654,875)	0		0	0	123,751	4,913,899	3,454,149
12/30/88	1,647,707	(804,875)	(20,000)		0	0	160,139	5,896,870	4,396,870
6/30/89	581,949	(650,000)	0		(68,051)	0	191,123	6,019,942	4,519,942
12/30/89	581,949	(850,000)	(20,000)		(288,051)	0	196,184	5,928,075	4,391,575
6/30/90	456,220	(643,250)	0		(187,030)	0	192,135	5,933,180	4,396,680
12/30/90	456,220	(893,250)	(20,000)		(457,030)	0	193,357	5,669,507	4,100,507
6/30/91	220,864	(634,500)	0		(413,636)	0	183,754	5,439,625	3,870,625
12/30/91	220,864	(934,500)	(20,000)		(733,636)	0	177,272	4,883,262	3,285,862
6/30/92	729,738	(623,700)	0		0	0	159,141	5,148,440	3,551,040
12/30/92	729,738	(973,700)	(20,000)		(263,962)	0	167,783	5,052,261	3,430,761
6/30/93	508,708	(610,750)	0		(102,042)	0	163,749	5,113,967	3,492,467
12/30/93	508,708	(1,010,750)	(20,000)		(522,042)	0	166,659	4,758,585	3,117,485
6/30/94	680,527	(595,550)	0		0	0	154,230	4,997,792	3,356,692
12/30/94	680,527	(1,043,550)	(20,000)		(385,023)	0	162,873	4,775,642	3,119,542
6/30/95	520,433	(578,000)	0		(57,567)	0	154,783	4,872,858	3,216,858
12/30/95	520,433	(1,078,000)	(20,000)		(577,567)	0	158,802	4,454,092	3,338,092
6/30/96	297,824	(558,000)	0		(260,176)	0	145,155	4,339,071	3,223,071
12/30/96	297,824	(558,000)	(20,000)		(280,176)	0	141,406	4,200,301	3,084,301
6/30/97	147,897	(558,000)	0		(410,103)	0	136,136	3,926,333	2,810,333
12/30/97	147,897	(558,000)	(20,000)		(430,103)	0	127,955	3,624,185	2,508,185
6/30/98	646,308	(558,000)	0		0	0	117,463	3,829,957	2,713,957
12/30/98	646,308	(558,000)	(20,000)		0	0	124,815	4,023,080	1,402,080
6/30/99	882,615	(558,000)	0		0	0	130,392	4,478,086	1,857,086
12/30/99	882,615	(2,063,000)	(20,000)		(1,200,385)	0	145,937	3,423,637	808,087
30/2000	1,157,108	(490,275)	0		0	0	111,573	4,202,043	1,586,493
30/2000	1,157,108	(2,125,275)	(20,000)		(988,167)	0	136,941	3,350,817	727,417
30/2001	990,243	(416,700)	0		0	0	108,603	4,032,963	1,409,563
30/2001	990,243	(2,206,700)	(20,000)		(1,236,457)	0	131,430	2,927,937	1,325,637
30/2002	575,447	(336,150)	0		0	0	94,897	3,262,132	1,659,832
30/2002	575,447	(1,266,150)	(20,000)		(710,703)	0	106,310	2,657,739	39,139
30/2003	326,912	(294,300)	0		0	0	86,140	2,776,490	157,890
30/2003	326,912	(2,324,300)	(20,000)		(2,017,388)	0	90,483	849,585	133,685
30/2004	851,668	(202,950)	0		0	0	27,687	1,525,989	810,089
30/2004	851,668	(512,950)	(20,000)		0	0	49,731	1,894,437	441,437
30/2005	1,410,677	(189,000)	0		0	0	61,401	3,177,515	1,724,515
30/2005	1,410,677	(1,264,000)	(20,000)		0	0	103,552	3,407,745	1,495
30/2006	790,257	(140,625)	0		0	0	110,448	4,167,825	761,575
30/2006	790,257	(3,265,625)	(20,000)		0	0	135,825	1,808,283	1,808,283
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	\$30,527,283	(\$35,000,508)	(\$400,000)	\$1,415,258	(\$11,589,297)	\$0			

STET-38.WR1



/ Single-Family Residen.(R-1-6000) //			Multi-Family Residential (P.U.D.)//			Total
Net Acreage			Acreage			Res. Asmts.
Left	Assessment	Total	Left	Assessment	Total	Due
/01/86	54.110		66.360			
6/30/87	38.160	\$20,455	51.610	\$29,660	\$1,530,740	\$2,311,302
2/30/87	22.210	20,455	36.860	29,660	1,093,258	1,547,564
6/30/88	11.105	22,347	18.430	32,403	597,192	845,357
2/30/88	0.000	22,347	0.000	32,403	0	0
6/30/89	0.000	24,414	0.000	35,401	0	0
2/30/89	0.000	24,414	0.000	35,401	0	0
6/30/90	0.000	26,673	0.000	38,675	0	0
2/30/90	0.000	26,673	0.000	38,675	0	0
6/30/91	0.000	29,140	0.000	42,253	0	0
2/30/91	0.000	29,140	0.000	42,253	0	0
6/30/92	0.000	31,835	0.000	46,161	0	0
2/30/92	0.000	31,835	0.000	46,161	0	0
6/30/93	0.000	34,780	0.000	50,431	0	0
2/30/93	0.000	34,780	0.000	50,431	0	0
6/30/94	0.000	37,997	0.000	55,096	0	0
2/30/94	0.000	37,997	0.000	55,096	0	0
6/30/95	0.000	41,512	0.000	60,192	0	0
2/30/95	0.000	41,512	0.000	60,192	0	0
6/30/96	0.000	45,352	0.000	65,760	0	0
2/30/96	0.000	45,352	0.000	65,760	0	0
6/30/97	0.000	49,547	0.000	71,843	0	0
2/30/97	0.000	49,547	0.000	71,843	0	0
6/30/98	0.000	54,130	0.000	78,488	0	0
2/30/98	0.000	54,130	0.000	78,488	0	0
6/30/99	0.000	59,137	0.000	85,748	0	0
2/30/99	0.000	59,137	0.000	85,748	0	0
30/2000	0.000	64,607	0.000	93,680	0	0
30/2000	0.000	64,607	0.000	93,680	0	0
30/2001	0.000	70,583	0.000	102,345	0	0
30/2001	0.000	70,583	0.000	102,345	0	0
30/2002	0.000	77,112	0.000	111,812	0	0
30/2002	0.000	77,112	0.000	111,812	0	0
1/2003	0.000	84,245	0.000	122,155	0	0
4Q/2003	0.000	84,245	0.000	122,155	0	0
0/2004	0.000	92,037	0.000	133,454	0	0
30/2004	0.000	92,037	0.000	133,454	0	0
30/2005	0.000	100,551	0.000	145,799	0	0
30/2005	0.000	100,551	0.000	145,799	0	0
30/2006	0.000	109,852	0.000	159,285	0	0
30/2006	0.000	109,852	0.000	159,285	0	0

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/..... Non-Residential (P.I.P) ...../				..... Non-Residential (P.B.C.) ...../			Total Non-
Year	Net Acreage Left	Assessment	Total Due	Net Acreage Left	Assessment	Total Due	Res. Asmts. Due
2/01/86	61.980			67.610			
3/30/87	51.430	\$74,865	\$3,850,322	65.260	\$122,116	\$7,969,313	\$11,819,635
12/30/87	40.880	74,865	3,060,493	62.910	122,116	7,682,340	10,742,833
06/30/88	33.680	81,790	2,754,699	61.310	133,412	8,179,497	10,934,195
12/30/88	26.480	81,790	2,165,808	59.710	133,412	7,966,037	10,131,845
06/30/89	21.680	89,356	1,937,237	58.660	145,753	8,549,855	10,487,092
12/30/89	16.880	89,356	1,508,328	57.610	145,753	8,396,815	9,905,143
06/30/90	13.430	97,621	1,311,055	56.860	159,235	9,054,094	10,365,149
12/30/90	9.980	97,621	974,261	56.110	159,235	8,934,668	9,908,929
06/30/91	8.480	106,651	904,403	55.760	173,964	9,700,237	10,604,641
12/30/91	6.980	106,651	744,426	55.410	173,964	9,639,350	10,383,776
06/30/92	3.490	116,517	406,643	53.710	190,056	10,207,895	10,614,538
12/30/92	0.000	116,517	0	52.010	190,056	9,884,800	9,884,800
06/30/93	0.000	127,294	0	49.560	207,636	10,290,436	10,290,436
12/30/93	0.000	127,294	0	47.110	207,636	9,781,728	9,781,728
06/30/94	0.000	139,066	0	44.110	226,842	10,006,011	10,006,011
12/30/94	0.000	139,066	0	41.110	226,842	9,325,485	9,325,485
06/30/95	0.000	151,933	0	39.010	247,825	9,667,659	9,667,659
12/30/95	0.000	151,933	0	36.910	247,825	9,147,226	9,147,226
06/30/96	0.000	165,987	0	35.810	270,749	9,695,521	9,695,521
12/30/96	0.000	165,987	0	34.710	270,749	9,397,697	9,397,697
06/30/97	0.000	181,341	0	34.210	295,793	10,119,087	10,119,087
12/30/97	0.000	181,341	0	33.710	295,793	9,971,191	9,971,191
06/30/98	0.000	198,115	0	31.710	323,154	10,247,218	10,247,218
12/30/98	0.000	198,115	0	29.710	323,154	9,600,909	9,600,909
06/30/99	0.000	216,440	0	27.210	353,046	9,606,379	9,606,379
12/30/99	0.000	216,440	0	24.710	353,046	8,723,764	8,723,764
30/2000	0.000	236,461	0	21.710	385,703	8,373,604	8,373,604
30/2000	0.000	236,461	0	18.710	385,703	7,216,496	7,216,496
30/2001	0.000	258,334	0	16.360	421,380	6,893,779	6,893,779
30/2001	0.000	258,334	0	14.010	421,380	5,903,536	5,903,536
30/2002	0.000	282,229	0	12.760	460,358	5,874,165	5,874,165
30/2002	0.000	282,229	0	11.510	460,358	5,298,718	5,298,718
1/2003	0.000	308,336	0	10.850	502,941	5,461,938	5,461,938
30/2003	0.000	308,336	0	10.210	502,941	5,135,026	5,135,026
30/2004	0.000	336,857	0	8.660	549,463	4,758,349	4,758,349
30/2004	0.000	336,857	0	7.110	549,463	3,906,681	3,906,681
30/2005	0.000	368,016	0	4.760	600,288	2,857,372	2,857,372
30/2005	0.000	368,016	0	2.410	600,288	1,446,695	1,446,695
30/2006	0.000	402,057	0	1.205	655,815	790,257	790,257
30/2006	0.000	402,057	0	0.000	655,815	0	0

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## STETSON HILLS PUBLIC BUILDING AUTHORITY

## Project Analysis (Collateral Only)

Year	Total Res. Assets. Due	Total Non- Res. Assets. Due	Supp. Const. Fund Replacement Acres	O/S Assets		Outstanding Bonds	Less:		Total Requirements Bond Fd. & Bond Fd. (Denominator)	110% Test
	Total Due	Due (Numerator)	Required Amount from Bond Fund	Reserve Fund, Suppl. Const. Requirements Bond Fd.						
12/01/86										
06/30/87	\$2,311,302	\$11,819,635	0.000	\$0	\$14,130,938	\$15,000,000	738,433	2,153,693	\$12,846,307	110.00%
12/30/87	1,547,564	10,742,833	1.592	32,554	12,322,951	15,000,000	2,337,567	3,797,317	11,202,683	110.00%
06/30/88	845,357	10,934,195	1.592	35,566	11,815,118	15,000,000	2,799,234	4,258,984	10,741,016	110.00%
12/30/88	0	10,131,845	1.592	35,566	10,167,411	14,850,000	4,106,899	5,606,899	9,243,101	110.00%
06/30/89	0	10,487,092	1.592	38,856	10,525,948	14,850,000	3,780,957	5,280,957	9,569,043	110.00%
12/30/89	0	9,905,143	1.592	38,856	9,943,999	14,650,000	4,073,501	5,610,001	9,039,999	110.00%
06/30/90	0	10,365,149	1.592	42,450	10,407,599	14,650,000	3,652,046	5,188,546	9,461,454	110.00%
12/30/90	0	9,908,929	1.592	42,450	9,951,379	14,400,000	3,784,292	5,353,292	9,046,708	110.00%
06/30/91	0	10,604,641	1.592	46,376	10,651,017	14,400,000	3,148,257	4,717,257	9,682,743	110.00%
12/30/91	0	10,383,776	1.592	46,376	10,430,153	14,100,000	3,020,643	4,618,043	9,481,957	110.00%
06/30/92	0	10,614,538	1.592	50,666	10,665,204	14,100,000	2,806,960	4,404,360	9,695,640	110.00%
12/30/92	0	9,884,800	1.592	50,666	9,935,466	13,750,000	3,096,258	4,717,758	9,032,242	110.00%
06/30/93	0	10,290,436	1.592	55,353	10,345,789	13,750,000	2,723,237	4,344,737	9,405,263	110.00%
12/30/93	0	9,781,728	1.592	55,353	9,837,081	13,350,000	2,766,099	4,407,199	8,942,801	110.00%
06/30/94	0	10,006,011	1.592	60,473	10,066,484	13,350,000	2,557,551	4,198,651	9,151,349	110.00%
12/30/94	0	9,325,485	1.592	60,473	9,385,958	12,900,000	2,711,311	4,367,311	8,532,689	110.00%
06/30/95	0	9,667,639	1.592	66,067	9,733,726	12,900,000	2,395,158	4,051,158	8,848,842	110.00%
12/30/95	0	9,147,226	1.592	66,067	9,213,293	12,400,000	2,908,279	4,024,279	8,375,721	110.00%
06/30/96	0	9,695,521	1.592	72,178	9,767,699	12,400,000	2,404,274	3,520,274	8,879,726	110.00%
12/30/96	0	9,397,697	1.592	72,178	9,469,875	12,400,000	2,675,023	3,791,023	8,608,977	110.00%
06/30/97	0	10,119,087	1.592	78,854	10,197,942	12,400,000	2,013,144	3,129,144	9,270,856	110.00%
12/30/97	0	9,971,191	1.592	78,854	10,050,045	12,400,000	2,147,595	3,263,595	9,136,405	110.00%
06/30/98	0	10,247,218	1.592	86,148	10,333,366	12,400,000	1,890,031	3,006,031	9,393,969	110.00%
12/30/98	0	9,600,909	1.592	86,148	9,687,058	12,400,000	972,584	3,593,584	8,806,416	110.00%
06/30/99	0	9,606,379	1.592	94,117	9,700,496	12,400,000	960,367	3,581,367	8,818,633	110.00%
12/30/99	0	8,723,764	1.592	94,117	8,817,881	10,895,000	263,195	2,878,745	8,016,255	110.00%
6/30/2000	0	8,373,604	1.592	102,823	8,476,427	10,895,000	573,607	3,189,157	7,705,843	110.00%
12/30/2000	0	7,216,496	1.592	102,823	7,319,319	9,260,000	0	2,623,400	6,636,600	110.29%
6/30/2001	0	6,893,779	1.592	112,334	7,006,113	9,260,000	267,406	2,890,806	6,369,194	110.00%
12/30/2001	0	5,903,536	1.592	112,334	6,015,870	7,470,000	398,728	2,001,028	5,468,972	110.00%
6/30/2002	0	5,874,165	1.592	122,725	5,996,890	7,470,000	415,982	2,018,282	5,451,718	110.00%
12/30/2002	0	5,298,718	1.592	122,725	5,421,443	6,540,000	0	2,618,600	3,921,400	138.25%
6/30/2003	0	5,461,938	1.592	134,077	5,596,015	6,540,000	0	2,618,600	3,921,400	142.70%
12/30/2003	0	5,135,026	1.592	134,077	5,269,103	4,510,000	0	715,900	3,794,100	138.88%
6/30/2004	0	4,758,349	1.592	146,479	4,904,828	4,510,000	0	715,900	3,794,100	129.28%
12/30/2004	0	3,906,681	1.592	146,479	4,053,160	4,200,000	0	1,453,000	2,747,000	147.55%
6/30/2005	0	2,857,372	1.592	160,028	3,017,400	4,200,000	3,909	1,456,909	2,743,091	110.00%
12/30/2005	0	1,446,695	1.592	160,028	1,606,723	3,125,000	0	3,125,000	0	0.00%
6/30/2006	0	790,257	1.592	174,831	965,088	3,125,000	0	3,125,000	0	0.00%
12/30/2006	0	0	1.592	174,831	174,831	0	0	0	0	0.00%

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No. 92-854

Supreme Court, U.S.

FILED

JUL 30 1993

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In The  
**Supreme Court of the United States**  
October Term, 1993

CENTRAL BANK OF DENVER, N.A.,

*Petitioner,*

v.

FIRST INTERSTATE BANK OF DENVER, N.A.  
and JACK K. NABER,

*Respondents.*

On Writ Of Certiorari  
To The United States Court Of Appeals  
For The Tenth Circuit

**BRIEF FOR PETITIONER**

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## QUESTIONS PRESENTED

1. Whether there is an implied private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.

2. Whether recklessness satisfies the scienter requirement for aiding and abetting even where there is no breach of a duty to disclose or to act.



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No. 92-854

In The

## Supreme Court of the United States

October Term, 1993

CENTRAL BANK OF DENVER, N.A.,

Petitioner,

v.

FIRST INTERSTATE BANK OF DENVER, N.A.  
and JACK K. NABER,

Respondents.

On Writ Of Certiorari  
To The United States Court Of Appeals  
For The Tenth Circuit

BRIEF FOR PETITIONER

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit is reported at 969 F.2d 891, and is reproduced in the Joint Appendix filed herewith ("J.A.") at page 183. The Order of the United States District Court for the District of Colorado is reproduced at J.A. 167.

## JURISDICTION

The judgment of the court of appeals was entered on July 8, 1992. J.A. 183. Petition for Rehearing was denied on August 18, 1992. By order dated September 10, 1992, the court of appeals stayed its mandate until November 17, 1992. Petitioner filed its Petition for Writ of Certiorari on November 12, 1992. On June 7, 1993, this Court granted the petition



limited to Question 2 presented by the petition and in addition directed the parties to brief and argue whether there is an implied private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1) (1988).

### STATUTE AND RULE INVOLVED

Section 10(b) of the Securities Exchange Act of 1934:  
15 U.S.C. § 78j. Manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange -

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities and Exchange Commission Rule 10b-5:  
17 C.F.R. § 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

### STATEMENT OF THE CASE

In 1986, and again in 1988, the Colorado Springs-Stetson Hills Public Building Authority (the "Authority") issued tax-exempt municipal bonds to finance the acquisition of public improvements built by the developer of Stetson Hills, a planned residential and commercial community in Colorado Springs, Colorado. J.A. 126-37. Repayment of the bonds was to be made from special lien assessments against lot sales in Stetson Hills and was secured by land in the development which was required to have an appraised value of 160% of the outstanding principal and interest based on an appraisal performed by an MAI appraiser ("160% Test"). *Id.*

Petitioner Central Bank of Denver, N.A. ("Central Bank")<sup>1</sup> served as indenture trustee for both the 1986 and 1988 bond issues (the "1986 Bonds" and the "1988 Bonds," respectively). Central Bank's duties and responsibilities as trustee are set forth in respective Indentures of Trust for the two bond issues, the operative provisions of which are identical (collectively referred to as the "Indenture"). J.A. 138-51. The developer of Stetson Hills ("Developer") was required to provide Central Bank on an annual basis evidence satisfactory to the bank that the 160% Test was being met. J.A. 52-54. In October of 1987, Central Bank asked the Developer to provide by year-end an appraisal report performed by an MAI appraiser pursuant to the methodology specified in the Indenture in order to provide that evidence. J.A. 75-77.

In January of 1988, the Developer provided Central Bank with an updated appraisal performed by the same appraiser who had conducted the original appraisal of the property. J.A. 60-62, 71-74. Central Bank rejected the appraisal because it included not only the property securing the 1986 Bonds but also the property to be used to secure the proposed 1988 Bonds. Shortly thereafter, separate appraisals were furnished to Central Bank. *Id.* The values of property securing the 1986

<sup>1</sup> Parent companies and subsidiaries of Central Bank are listed in its Petition for Writ of Certiorari at page ii.

Bonds remained essentially unchanged from those reflected in the original appraisal conducted in 1986. J.A. 63-64, 67-68.

At that same time, a controversy arose concerning the Developer's compliance with the 160% Test and the adequacy of the updated appraisal. In late January of 1988, Central Bank received a letter from the senior underwriter for the 1986 Bonds ("1986 Underwriter") stating that the 160% Test was probably not being met and raising concerns over reliance upon the original 1986 appraisal in light of declining property values and increasing foreclosures in Colorado Springs. J.A. 84-96. In response, the Developer corresponded with Central Bank, stating that an appraisal had recently been completed and that the claims of the 1986 Underwriter were "unfounded." J.A. 97-98. The lead underwriter for the proposed 1988 Bonds ("1988 Underwriter") also disputed the 1986 Underwriter's proposed method of calculating the 160% Test. J.A. 99-103.

In order to resolve the controversy, a meeting was convened in February of 1988 involving representatives of the Developer, Central Bank, and others. J.A. 65-67. The participants in the meeting discussed the appropriate methodology for calculating the 160% Test.<sup>2</sup> As a result of concerns over whether the 160% Test had been calculated correctly, the Developer agreed to contribute additional land to secure the 1986 Bonds. J.A. 69-70. In addition, in response to questions from Central Bank as to why the updated appraisal did not show a decline in land values from the original appraisal, a representative of the Developer stated that the values were substantially unchanged because \$10 million worth of improvements had been added to the property since the original appraisal was done. J.A. 67-68.

In late February of 1988, after reviewing the updated appraisal, the 1986 Underwriter sent another letter to Central

<sup>2</sup> The methodology issue centered specifically on whether an interest component in the calculation should be simple interest or compounded. J.A. 101-02. A representative of Central Bank had confirmed at that time through her own calculations that the 160% Test may not have been met because of this problem. J.A. 65-66.

Bank stating that the appraiser was relying on old data not reflective of the current market. J.A. 106-10. As a result, Central Bank asked an in-house appraiser at the bank to review the appraisal.<sup>3</sup> J.A. 71-72. Upon review of the appraisal, the bank's appraiser also had questions as to the age of the comparable sales used and whether the methodology specified in the Indenture was followed. J.A. 64-65, 71-74. Due to his own time constraints, the in-house appraiser suggested that an independent, outside appraiser be hired to review the appraisal in order to follow up on these questions. J.A. 44-45.

On March 22, 1988, Central Bank sent a letter to the Developer instructing that an independent review of the appraisal be completed by a different appraiser to be selected subject to the bank's approval. The letter specified three reasons for the request. First, the age of the comparable sales data made it of questionable reliability, prompting Central Bank to inquire why more recent sales were not utilized. Second, the appraiser had confirmed that the discounting methods did not consider a bulk sale in a forced liquidation context, as specified in the Indenture. Third, the values determined by the appraiser appeared unjustifiably optimistic given the current economic conditions in the Colorado Springs market. J.A. 116-17.

After this letter was sent, the manager of Central Bank's corporate trust department took an active role in discussions concerning the 1986 Bonds. J.A. 68-69. On March 31, 1988, he met with representatives of the Developer and the 1988 Underwriter to discuss Central Bank's requirement of an independent review of the appraisal. J.A. 48-49, 52-54, 71-74. The Developer's representative confirmed that the Developer was willing to pledge an additional \$2 million of land to the assessment lien for the 1986 Bonds. J.A. 49-52, 119. Concerning the appraisal, the Developer's representative informed Central Bank that the appraiser had, in fact, reviewed more recent comparable sales data, which were in

<sup>3</sup> The in-house appraiser worked in the bank's lending area and did not recall another situation where he was asked to review an appraisal relating to a bond issue in which Central Bank was acting as trustee. J.A. 44, 116-17.



conformance with the values in the appraisal, and had correctly followed the specified bulk sale discounting methodology. J.A. 73. The Developer's representative offered to obtain a letter from the appraiser confirming these facts. *Id.* In addition, he stated that the Developer did not want to have another appraisal performed at that time but would be willing to have a new appraisal completed by a different appraiser by year-end. J.A. 51-52. After the meeting, Central Bank's trust manager spoke with the bank's in-house appraiser who had confirmed with the Developer's appraiser that he properly followed the bulk sale methodology.<sup>4</sup> J.A. 45-47, 54-55.

On or about April 5, 1988, Central Bank's Corporate Trust Committee approved the Developer's proposal relating to the 1986 Bonds. J.A. 71-74. However, Central Bank imposed upon the Developer several conditions to its acceptance. Among these conditions were that the appraiser supplement his current appraisal with a letter pertaining to the bank's concerns on comparable sales data and the bulk sales methodology, that a new appraisal be performed by a specified appraiser by December 10, 1988, and that additional property valued at approximately \$2 million be added to the assessment lien to bring the 1986 Bonds into compliance with the 160% Test. J.A. 120-23.

After resolving its concerns with respect to the 1986 Bonds, Central Bank turned its attention to the proposed 1988 Bonds. Central Bank's trust manager believed that the bond documents were not clear as to whether the appraisal used to support the 160% Test could include a "bring-down certificate" or updated appraisal as opposed to an entirely new appraisal. J.A. 52-55. Under the Indenture, Central Bank had the right to demand additional appraisals in connection with its responsibilities, but was not required to do so. J.A. 144-45. On May 13, 1988, Central Bank entered into a letter agreement with the Authority and the Developer which required that appraisals be provided to Central Bank on an annual basis

<sup>4</sup> The bank's appraiser apparently still believed that the appraisal "could be optimistic," but there is no evidence that he communicated this belief to Central Bank's trust manager. J.A. 44.

related to the 1986 Bonds and the proposed 1988 Bonds, with the first of such appraisals to commence by December 1, 1988, and to be completed within 90 days. J.A. 124-26. Central Bank's trust manager stated that the purpose of the letter agreement was to clarify what the bank would require in the future in order to avoid any confusion. J.A. 57-58.

The 1988 Bond issue closed on June 15 and 16, 1988, at which time Central Bank received the appraiser's certification stating, among other things, that other comparable sales were considered and did not materially alter the values in the report and that the bulk sale discounting methodology specified in the Indenture was followed. J.A. 71-74, 151-54. In carrying out its duties of authenticating and delivering the 1988 Bonds, Central Bank accepted the appraisal, the appraiser's certificate, and a certificate by the Authority and the Developer that the 160% Test had been met.<sup>5</sup> J.A. 71-74, 151-54.

When the Developer failed to complete the first annual appraisal as required by the May 13, 1988 letter agreement, Central Bank sent notices to bondholders informing them that the Authority was in technical default. J.A. 154-62. Subsequently, the Authority defaulted on monetary payments on the 1988 Bonds. J.A. 163-66.

After the monetary default, the Respondents, two holders of 1988 Bonds, brought an action against the Authority, the 1988 Underwriter, a junior underwriter on the bonds, a director of the Developer, and Central Bank. Respondents allege that the sale of the bonds was in violation of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1988), and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (1992), promulgated thereunder.<sup>6</sup>

<sup>5</sup> The bank did not participate in the preparation of the disclosure documents relating to the 1988 Bonds. While drafts of the disclosure documents were provided to Central Bank, its representatives reviewed them only to assure that its name was properly stated, and none of its representatives attended drafting sessions concerning the disclosure documents. J.A. 71-74, 81-84, 111-15.

<sup>6</sup> The Authority, the underwriter defendants and the director of the Developer were all sued for alleged primary violations of § 10(b) and under secondary liability



Respondents claim that the 1988 Bonds were issued and marketed both through a fraudulently misleading disclosure document, which did not disclose the questions raised concerning the appraisal and the 160% Test in connection with the 1986 Bonds, and by means of a scheme to delay an independent review of the appraisal until six months after the 1988 Bonds were issued. Central Bank is alleged to have knowingly or recklessly aided and abetted the § 10(b) violation by its decision as trustee to postpone an independent review of the appraisal until after the issuance of the 1988 Bonds and by its failure to alert investors in the 1988 Bonds of the risks connected with the appraisal. J.A. 3-27.

The district court granted summary judgment for Central Bank, holding that the scienter requirement for aiding and abetting liability "may not be satisfied by showing recklessness absent an additional duty to disclose" and finding no genuine issue of material fact as to the bank's knowledge or a duty to disclose. J.A. 167-76. The court of appeals reversed and remanded, holding that aiding and abetting liability based upon recklessness could be established absent a duty to disclose when the defendant assists the primary violation by "affirmative action." The court agreed with the district court that Central Bank owed no disclosure duty to Respondents, and that it had complied with its duties under the Indenture. However, purporting to rely on *Levine v. Diamanthuset, Inc.*, 950 F.2d 1478 (9th Cir. 1991), and *FDIC v. First Interstate Bank*, 885 F.2d 423 (8th Cir. 1989), the court held that recklessness was sufficient to impose liability, since Central Bank affirmatively agreed to delay the independent review of the appraisal.<sup>7</sup> Reviewing the evidence in the light most

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theories of conspiracy and aiding and abetting and, in the case of the director of the Developer, controlling person liability under section 20 of the Securities Exchange Act, 15 U.S.C. § 78t (1988). Central Bank was named only as an alleged aider and abettor of the primary violations of others. J.A. 3-27.

<sup>7</sup> The court of appeals noted that the district court order only dealt with plaintiffs' claims of affirmative acts by Central Bank and it construed a statement by plaintiffs in their reply brief on appeal as an abandonment of their claim that Central Bank improperly remained silent. J.A. 207 n.18.

favorable to plaintiffs, the court concluded that Central Bank's conduct could support a finding of extreme departure from the standards of ordinary care and thus constitute recklessness. In light of its disposition on the recklessness issue, the court did not reach the issue of the bank's knowledge of the alleged fraud. Finally, the court held that plaintiffs had raised a genuine issue of material fact on the substantial assistance element because the trier of fact could reasonably conclude that had Central Bank not agreed to delay the independent review of the appraisal, the inadequacy of the collateral would have been discovered and the bondholders' losses avoided. J.A. 183-213.

### SUMMARY OF ARGUMENT

In 1971, an implied private right of action against primary violators of § 10(b) of the Securities Exchange Act of 1934 (the "1934 Act") was recognized by this Court. Since then, the Court has twice reserved the question of whether there is a similar private right of action for aiding and abetting § 10(b) violations, and on several occasions has instructed that additional private rights under § 10(b) are to be implied only if it appears that Congress would have included the asserted right within § 10(b) had it considered the matter, and if the right is consistent with the language of § 10(b). By reversing the district court's grant of summary judgment in favor of Central Bank, the court of appeals has embraced an implied right of action for aiding and abetting which fails both these conditions. There is nothing to suggest that Congress would have chosen to include aiding and abetting liability within the private remedies under § 10(b). To the contrary, Congress' actions demonstrate that it deliberately omitted any private aiding and abetting right from the 1934 Act. Furthermore, in the absence of any duty to disclose or to act, aiding and abetting liability based only on recklessness is an impermissible departure from the language of § 10(b), which reaches only manipulative or deceptive conduct.

Every tool of statutory construction this Court has used with respect to implied rights of action under the securities

acts weighs heavily against implication of a private right of action for aiding and abetting a violation of § 10(b). The language of § 10(b) provides no support for any aiding and abetting theory. Rather, the language is directly at odds with the concept of aiding and abetting, which requires manipulative or deceptive conduct by the primary violator, not by the assisting defendant. Examination of analogous provisions of the 1934 Act further dispels any inference that Congress would have intended private aiding and abetting rights. Aiding and abetting language is conspicuously absent from provisions in the 1934 Act granting express private rights of action, particularly §§ 9 and 18, which the Court has described as most analogous to the implied § 10(b) private right. Congress has repeatedly incorporated aiding and abetting language into provisions creating criminal liability and granting civil enforcement powers to the Securities and Exchange Commission ("SEC"), yet has declined to add aiding and abetting to § 20 of the 1934 Act, the provision which creates express liability against controlling persons. By limiting derivative liability to controlling persons, Congress has manifested its intention not to institute derivative liability in private actions against aiders and abettors. It is evident that Congress knows how to create derivative liability, and specifically aiding and abetting liability, within the 1934 Act. It has chosen not to impose a private right of action against aiders and abettors.

Lower courts have nevertheless perpetuated the concept of an implied aiding and abetting right, despite the increasing criticism levied against it. This implied right was borrowed from tort law. However, this Court has since held that a private right of action under the securities laws cannot be implied based on tort principles, but instead must flow from the rigorous statutory construction analysis laid down by this Court.

Even if an adequate basis existed for an implied right of action against aiders and abettors under § 10(b), *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), makes clear that no liability may be imposed unless the defendant is guilty of conduct of a manipulative or deceptive nature. Central Bank

is not. As the court of appeals held, Central Bank owed Respondents no duty to disclose or to act. Central Bank exercised its discretion under the Indenture to ask the Developer for an independent review of its appraisal, when the bank was under no obligation to do so. After receiving assurances that the perceived problems with the appraisal were without merit, Central Bank again used its discretion in deciding to wait six months for a new appraisal. While this decision has since been second-guessed by Respondents, there is no suggestion in the record that Central Bank intended to deceive Respondents or even that the bank knew they were being deceived. The court of appeals made no such finding, holding only that Central Bank may have been reckless in agreeing to wait for the new appraisal. Because it deemed this an affirmative action, the court found recklessness a sufficient basis for aiding and abetting liability, improperly divorcing its scienter analysis from the requirement of manipulative or deceptive conduct.

The flaw in the approach of the court below stems from its failure to consider whether Central Bank owed any relevant duty to disclose or to act. As the majority of the courts of appeals have agreed, recklessness can be sufficient scienter for aiding and abetting a securities fraud, if ever, only where the defendant owed some duty to the plaintiff. It is reasonable to equate recklessness with deception only where the relationship between the defendant and plaintiff created an expectation by the plaintiff that the defendant would speak or act to protect the plaintiff's interest. If the defendant had no duty to speak or to act, it cannot have deceived the plaintiff without possessing either actual knowledge of the fraud committed by the primary violator or conscious intent to further the fraud.

The court of appeals abandoned this rule in favor of its new theory that recklessness is sufficient whenever the defendant takes an affirmative action which in some way assists the fraud. This view fails both on a conceptual level, because it ignores the requirement of deception by the defendant, and as a practical matter, because it focuses entirely on the tenuous and unworkable distinction between action and inaction. Given the potential damage the Tenth Circuit's new rule could



inflict on legitimate business entities that assist in securities transactions in full compliance with their state law duties, the Court should reverse the decision of the court of appeals and reinstate the district court's grant of summary judgment in favor of Central Bank.

## ARGUMENT

### I. THERE IS NO IMPLIED PRIVATE RIGHT OF ACTION FOR AIDING AND ABETTING VIOLATIONS OF SECTION 10(b) AND RULE 10b-5.

In recent decisions involving implied private rights of action under § 10(b),<sup>8</sup> this Court has "made no pretense that it was Congress' design to provide the remedy afforded." *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S.Ct. 2773, 2780 (1991). Implied private rights under § 10(b) constitute "a judicial oak which has grown from little more than a legislative acorn." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975).<sup>9</sup> In determining the nature and extent of private rights, however, the Court continues to give as much deference as possible to Congressional policies. To that end, the Court's statutory construction analysis involves first an examination of the language of the relevant section at issue and then a review of comparable express remedial provisions in order "to infer how the 1934 Congress would have addressed the issue had the 10b-5 action been included as an express provision in the 1934 Act." *Musick*,

<sup>8</sup> This case concerns the existence and scope of implied private rights of action for aiding and abetting violations of § 10(b) and Rule 10b-5. The SEC adopted Rule 10b-5 pursuant to the authority granted by § 10(b) and the scope of Rule 10b-5 cannot exceed that of § 10(b) itself. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 212-14 (1976); see also *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 472 (1977) ("the language of the statute must control the interpretation of the Rule"). For this reason, the discussion in Petitioner's brief shall be limited throughout to the availability of implied private rights of action under § 10(b).

<sup>9</sup> *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), first implied a private right of action under § 10(b). The right was recognized by this Court in *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971).

*Peeler & Garrett v. Employers Ins. of Wausau*, 113 S.Ct. 2085, 2089-90 (1993). Applying this standard, it is evident that § 10(b) was intended to reach only defendants who themselves engage in manipulative or deceptive acts and not those who, by their action or inaction, assist such conduct by others. Likewise, the comparable sections of the 1934 Act previously used by this Court as a measure of Congress' hypothetical intent offer no hint that the 1934 Congress would have swept alleged aiders and abettors into the § 10(b) net. Rather, the Act reveals a clear Congressional intent to incorporate aiding and abetting only in very limited circumstances analogous to the theory's criminal law origins, and not to include it within the private derivative liability permitted by the Act.

#### A. An Implied Private Right Of Action For Aiding And Abetting Is Contrary To The Express Language Of Section 10(b).

The court of appeals imposed aiding and abetting liability against Central Bank without analyzing the basis for a private right of action for aiding and abetting under § 10(b).<sup>10</sup> Such a private right cannot withstand serious scrutiny under the standards identified by this Court. An aiding and abetting right is not provided by the statute, nor is such a right consistent with its express language.<sup>11</sup>

<sup>10</sup> Neither party raised the issue below because the Tenth Circuit, like many other circuits, had previously upheld private aiding and abetting claims under § 10(b) without analysis. See *Farlow v. Peat, Marwick, Mitchell & Co.*, 956 F.2d 982 (10th Cir. 1992); Section I.C., *infra*.

<sup>11</sup> This Court has twice considered and reserved judgment on whether the application of aiding and abetting to § 10(b) in private actions is justified by the language and intent of the 1934 Act. *Ernst & Ernst*, 425 U.S. at 191 n.7; *Herman & MacLean v. Huddleston*, 459 U.S. 375, 379 n.5 (1983). The courts of appeals have uniformly assumed the existence of a private right of action for aiding and abetting, deriving the theory from general tort law principles. See Section I.C., *infra*.



### 1. Section 10(b) Does Not Provide Liability For Aiding And Abetting.

This Court has had occasion in many recent cases to consider asserted implied rights under § 10(b) and related provisions of the securities laws. The focus in determining whether to recognize an implied right is how the 1934 Congress would have addressed the issue. *Musick*, 113 S.Ct. at 2089-90. The clearest indicator of the intentions of Congress is always the statute itself. "The question of the existence of a statutory cause of action is, of course, one of statutory construction." *Touche Ross & Co. v. Redington*, 442 U.S. 560, 568 (1979) (citations omitted). The Court must therefore look first to the language chosen by Congress. *Ernst & Ernst*, 425 U.S. at 197 ("we turn first to the language of § 10(b), for '[t]he starting point in every case involving construction of a statute is the language itself' ") (quoting *Blue Chip Stamps*, 421 U.S. at 756 (Powell, J., concurring)).

Section 10(b) makes it "unlawful for any person, directly or indirectly . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance. . . ." The language of § 10(b) is expressly limited to primary violators, the perpetrators of securities fraud. The statute creates only direct liability, not derivative liability based on the primary violations of others. *Musick*, 113 S.Ct. at 2090. No provision is made for aiding and abetting or other forms of secondary liability.

Nor does the legislative history provide any support for the belief that § 10(b) extends to aiders and abettors. The Court previously examined the sparse legislative history of § 10(b) in *Ernst & Ernst*, concluding that the provision was intended "to enable the Commission 'to deal with new manipulative [or cunning] devices.'" *Ernst & Ernst*, 425 U.S. at 203 (brackets in original) (quoting *Hearings on H.R. 7852 and H.R. 8720 before the House Committee on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 115 (1934) (remarks of Thomas G. Corcoran)). Thus, the legislative history reflects Congress' concern with parties who perpetrate some form of cunning device, and shows no intention to reach those who are merely negligent, as held in *Ernst & Ernst*, or those

who merely in some way assist another in committing a violation. The right of action asserted by Respondents simply has no basis in the underlying statute.

### 2. An Implied Private Right Of Action For Aiding And Abetting Is Inconsistent With The Language Of Section 10(b), Which Proscribes Only Manipulative Or Deceptive Conduct.

The failure of Congress to provide for aiding and abetting liability in § 10(b) is fatal to Respondents' claim because to imply such a cause of action would be inconsistent with the language that *is* included in the provision. Creation of an implied aiding and abetting right goes far beyond recognition of an implied private right against primary violators of § 10(b). The cause of action Respondents ask this Court to endorse would improperly allow private parties to seek damages under § 10(b) for actions which are not proscribed by that provision.

Section 10(b) does not make explicit provision for any private rights of action, yet this Court recognized an implied right against primary violators of the statute in *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971). However, while the statute is ambiguous as to the existence of a private right of action under § 10(b), it is not ambiguous as to who is a proper defendant in any such action, if recognized. A private right can lie, at most, against those who have violated the terms of the statute. It cannot extend to third parties who may simply have been of assistance to the primary violator.

In declining to recognize an implied private right of action under section 17(a) of the 1934 Act, 15 U.S.C. § 78q(a) (1988), this Court explained the necessary basis for any implied right of action:

It is true that in the past our cases have held that in certain circumstances a private right of action may be implied in a statute not expressly providing one. But in those cases finding such implied private remedies, the statute in question *at least prohibited*

certain conduct or created federal rights in favor of private parties.

*Touche Ross*, 442 U.S. at 569 (emphasis added) (citations omitted). Section 10(b) does prohibit certain conduct, namely, manipulative or deceptive devices or contrivances. Thus, courts may be justified in permitting a private right of action against defendants who engage in such manipulative or deceptive conduct. "However, under a strict aiding and abetting analysis, it is irrelevant whether an aider and abettor has engaged in a manipulative or deceptive practice within the meaning of section 10(b). What is relevant is whether the primary violator engaged in such a practice." Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Cal. L. Rev. 80, 88 (1981) (emphasis in original). Thus, aiding and abetting liability would permit private actions against defendants who are not themselves guilty of manipulative or deceptive conduct.

Aiding and abetting liability would therefore thwart the "manipulative or deceptive" standard which this Court has treated as crucial to any action under § 10(b). In *Ernst & Ernst v. Hochfelder*, the Court stressed this language, which it found inconsistent with a private right of action under § 10(b) based on negligent conduct by the defendant. The words "manipulative," "device," and "contrivance" in § 10(b) all refer to a particular type of fraudulent conduct and the phrase "[t]o use or employ" clearly requires fraudulent conduct by the defendant. 425 U.S. at 199 & n.20. The Court again invoked this language in refusing to allow a private right under § 10(b) by minority shareholders claiming a breach of fiduciary duty by the majority. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 473 (1977) ("The language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception."). It is incompatible with the crucial language of § 10(b) to impose liability in a private action against a defendant who is not the party guilty of the fraudulent conduct proscribed by § 10(b).

This inherent incompatibility exists without regard to the level of scienter required for aiding and abetting liability. Whatever the degree of scienter, the aider and abettor is not

required to have engaged in manipulative or deceptive conduct, but merely to have substantially assisted such conduct. Each of the courts of appeals which has addressed the issue considers "substantial assistance" of a primary violation of § 10(b) an element of aiding and abetting liability, although there is little uniformity in the courts' application of the "substantial assistance" standard.<sup>12</sup> Because substantial assistance of a primary violation is not the conduct prohibited by the statute, courts are entirely without guidance as to who may be subjected to liability.<sup>13</sup> By refusing to extend an implied private right of action to alleged aiders and abettors of § 10(b) violations, the Court can eliminate the conceptual quagmire of the substantial assistance test while honoring the Congressional intent to require manipulative or deceptive conduct by the defendant.

#### B. An Implied Private Right Of Action For Aiding And Abetting Violations Of Section 10(b) Is Contrary To The Congressional Intent Embodied In The 1934 Act.

In ruling on an implied private right of action under the securities laws, the Court's "task is limited solely to determining

<sup>12</sup> See, e.g., *Dirks v. SEC*, 681 F.2d 824, 844 (D.C. Cir. 1982), *rev'd on other grounds*, 463 U.S. 646 (1983); *Cleary v. Perfectum, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983); *ITT v. Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980); *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 800 (3d Cir. 1978), *cert. denied*, 439 U.S. 930 (1978); *Schatz v. Rosenberg*, 943 F.2d 485, 495 (4th Cir. 1991), *cert. denied*, 112 S.Ct. 1475 (1992); *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 97 (5th Cir. 1975); *Moore v. Fenex, Inc.*, 809 F.2d 297, 303 (6th Cir. 1987), *cert. denied*, 483 U.S. 1006 (1987); *Camp v. Dema*, 948 F.2d 455, 459 (8th Cir. 1991); *Levine v. Diamantheset, Inc.*, 950 F.2d 1478, 1483 (9th Cir. 1991); *Woods v. Barnett Bank of Fort Lauderdale*, 765 F.2d 1004, 1009 (11th Cir. 1985). Substantial assistance of the primary violation is also necessary in the Seventh Circuit, but there the test has been greatly overshadowed by the further requirement that the aider and abettor meet all standards for primary liability except that the aider and abettor need not sell the securities. See, e.g., *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495-96 (7th Cir. 1986). The Seventh Circuit is thus the only court of appeals which requires manipulative or deceptive conduct by the defendant to impose § 10(b) aiding and abetting liability.

<sup>13</sup> The amorphous standard of "substantial assistance" is reminiscent of the "substantial factor" test for determining who could be liable under § 12(1) of the 1933 Act rejected by this Court in *Pinter v. Dahl*, 486 U.S. 622 (1988).



whether Congress intended to create the private right of action asserted." *Touche Ross*, 442 U.S. at 568; accord, *Virginia Bankshares, Inc. v. Sandberg*, 111 S.Ct. 2749, 2763 (1991); *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 15-16 (1979). The relevant inquiry with respect to § 10(b) and Rule 10b-5 is "how Congress would have balanced the policy considerations" presented. *Lampf*, 111 S.Ct. at 2780. A review of the structure of the 1934 Act reveals Congress' intentions with respect to aiders and abettors – Congress expressly provided for aiding and abetting liability in disciplinary actions brought by the SEC, but conspicuously omitted any cause of action against aiders and abettors in the provisions creating private rights of action. Section 10(b), like the provisions of the 1934 Act which create express private rights of action, does not reach aiding and abetting.

**1. Provisions In The 1934 Act Which Convey Express Private Rights Of Action Do Not Create Any Rights Against Aiders And Abettors.**

While Congress did not contemplate a private right of action under § 10(b) in 1934, it did enact other provisions of the 1934 Act, as well as the Securities Act of 1933 (the "1933 Act"), which explicitly created private rights of action. In determining the extent of implied private rights of action under § 10(b), the Court has looked to these provisions, particularly §§ 9 and 18 of the 1934 Act, which it has deemed most analogous to § 10(b) in structure, purpose, and intent. Since Congress chose not to include express rights against aiders and abettors in those provisions, no implied right may lie against aiders and abettors under § 10(b).

In discerning the extent of implied private rights of action under a given statute, the inquiry is most easily resolved by looking to comparable express remedial provisions in the statute. *Lampf*, 111 S.Ct. at 2780. This Court has identified eight provisions of the 1933 and 1934 Acts which create express private rights of action, §§ 11, 12, and 15 of the 1933 Act, 15 U.S.C. §§ 77k, 77l, 77o (1988) and §§ 9, 16, 18, 20, and 20A of the 1934 Act, 15 U.S.C. §§ 78i, 78p, 78r,

78t, 78t-1 (1988). *Musick*, 113 S.Ct. at 2090-91. Not one of these creates a right of action against aiders and abettors.

Particularly significant among these provisions are §§ 9 and 18 of the 1934 Act. Sections 9 and 18, respectively, create private civil liability for effecting a manipulation of securities prices and for making misleading statements in filings with the SEC. In its recent decisions in *Lampf* and *Musick*, this Court relied upon these provisions in ruling on the scope of the implied private right of action under § 10(b). These two sections "target the precise dangers that are the focus of § 10(b)," *Lampf*, 111 S.Ct. at 2781, and "impose liability upon defendants who stand in a position most similar to 10b-5 defendants." *Musick*, 113 S.Ct. at 2090. Both § 9 and § 18 explicitly provide a statute of limitations of one year from discovery with a three year period of repose. 15 U.S.C. §§ 78i(e), 78r(c) (1988). The Court adopted this statute of limitations to implied rights of action under § 10(b) in *Lampf*. Both § 9 and § 18 explicitly provide defendants a right of contribution against parties who share joint responsibility for violation of the provisions. 15 U.S.C. §§ 78i(e), 78r(b) (1988). The Court therefore reasoned in *Musick* that the 1934 Congress would have granted a right of contribution to defendants in implied private 10(b) actions had it considered the question.

Section 9 and § 18 do not, however, provide any explicit rights of action against aiders and abettors.<sup>14</sup> Whereas an

<sup>14</sup> Lower courts in three reported decisions arguably assumed with little or no discussion the existence of an implied private right of action against aiders and abettors under these provisions, but each case centered primarily on violations of other securities provisions, particularly § 10(b) and Rule 10b-5, and the courts simply lumped actions under §§ 9 or 18 together with the presumed implied private right against aiders and abettors under § 10(b). See *Sennott v. Rodman & Renshaw*, 474 F.2d 32 (7th Cir. 1973) (finding insufficient evidence to support trial court's judgment against defendants for aiding and abetting securities fraud which violated § 10(b), Rule 10b-5, § 9(a)(4), and § 17(a) of the 1933 Act), cert. denied, 414 U.S. 926 (1973); *In re Investors Funding Corp. of New York Sec. Litig.*, 523 F. Supp. 533 (S.D.N.Y. 1980) (dismissing claims for aiding and abetting violations of §§ 10(b) and 18); *In re Caesars Palace Sec. Litig.*, 360 F. Supp. 366, 386 (S.D.N.Y. 1973) (holding that § 18, like "the federal securities laws as a whole," permits aiding and abetting liability). Since it is the existence of such an implied right under § 10(b) which the Court must now decide, these opinions are of little assistance.



implied private right for contribution under § 10(b) was appropriate given that Congress had allowed contribution in the express remedies it created, under the same logic there can be no implied right of action under § 10(b) against aiders and abettors. The failure of Congress to create aiding and abetting liability where it imposed express private rights of action precludes a finding that a right against aiders and abettors is implied under § 10(b).

## 2. Congress Has Specified Which Provisions In The Securities Acts It Intended To Reach Aiders And Abettors.

In sharp contrast to the express private rights of action contained in the 1934 Act, which do not mention aiding and abetting, Congress has explicitly authorized criminal liability and disciplinary actions by the SEC based on aiding and abetting, while refusing to amend the 1934 Act to include private civil aiding and abetting remedies. Congress' use of aiding and abetting language only in enforcement provisions is entirely incompatible with judicial creation of an implied private right of action for aiding and abetting.

Congress long ago created general criminal liability for aiding and abetting criminal violations of federal law. See 18 U.S.C. § 2(a) (1988). This provision, which dates back to 1909, reaches aiders and abettors of criminal violations of the securities laws. Alan R. Bromberg & Lewis D. Lowenfels, *Aiding and Abetting Securities Fraud: A Critical Examination*, 52 Alb. L. Rev. 637, 766 (1988); see, e.g., *United States v. Re*, 336 F.2d 306, 318 (2d Cir. 1964), cert. denied, 379 U.S. 904 (1964). Thus, from the time of its enactment, aiding and abetting criminal violations of the 1934 Act has always been a separate criminal offense.

Whereas Congress has always endorsed criminal aiding and abetting liability, it has declined to add aiding and abetting language to the 1934 Act's private civil liability provisions. In particular, a bill introduced in 1959 would have altered the caption of § 20 of the 1934 Act from "Liabilities of Controlling Persons" to "Liabilities of Controlling and Associated Persons," and made it "unlawful for any person to

aid, abet, counsel, command, induce or procure the violation of any provision of [the 1934 Act] or any rule or regulation thereunder by any other person." H.R. 2480, 86th Cong., 1st Sess. §§ 21, 22 (1959); S. 1179, 86th Cong., 1st Sess. §§ 21, 22 (1959). The SEC advocated this language arguing that aiders and abettors should be "culpable in administrative or injunction actions brought against them." *SEC Legislation: Hearings before a Subcommittee of the Committee on Banking and Currency, United States Senate, 86th Cong., 1st Sess., on S. 1178, S. 1179, S. 1180, S. 1181, and S. 1182*, 276 (1959) (hereinafter "*SEC Legislation Hearings*"). The Commission explained that the language would be applied in accordance with the criminal law theory of aiding and abetting, which requires that the defendant "in some sort associate himself with the venture, that he participate in it as in something that he wishes to bring about, that he seek by his action to make it succeed." *Id.* at 276 (quoting *United States v. Peoni*, 100 F.2d 401, 402 (2d Cir. 1938) (L. Hand, J.)). The provision was apparently not contemplated as an endorsement of broad new private rights against aiders and abettors.

Nevertheless, the proposed addition of aiding and abetting language to § 20 prompted "industry fears that private litigants, not only the SEC, may find in this section a vehicle by which to sue aiders and abettors." *SEC Legislation Hearings* at 288, 370. The proposal was rejected despite the Commission's suggestion that the legislation could be revised to clarify that no private civil liability was intended. *Id.* Similar aiding and abetting measures also failed in 1957 and 1960. See S. 2545, 85th Cong., 1st Sess. § 19 (1957); S. 3770, 86th Cong., 2d Sess. § 20 (1960).

Congress' decision not to enact any of these proposals demonstrated its intention not to incorporate a private right of action against aiders and abettors into the 1934 Act. Indeed, this Court relied upon identical legislative history in determining Congressional intent in *Blue Chip Stamps*, 421 U.S. at 732-33. There the Court declined to expand the "purchase or sale" requirement of § 10(b) to allow a right of action to offerees of a stock offering. The Court observed that in 1957

and 1959 Congress considered legislation to include within § 10(b) "any attempt to purchase or sell" a security. This proposal appeared in the same bills which contained the aiding and abetting language discussed above. H.R. 2480, 86th Cong., 1st Sess. § 10 (1959); S. 1179, 86th Cong., 1st Sess. § 10 (1959). The SEC supported both the "attempt to purchase" and the aiding and abetting provisions but in both instances noted industry fears of the expansion of civil liabilities which could result. See *SEC Legislation Hearings* at 288, 368, 370. In *Blue Chip Stamps*, the court concluded that by not adopting the "attempt to purchase" language, Congress evidenced its intent not to dilute the "purchase or sale" requirement. 421 U.S. at 732-33. By the same token, Congress' failure to adopt the aiding and abetting provision in the same proposed legislation reveals its choice not to create private civil aiding and abetting liability.<sup>15</sup>

In contrast to its decision not to include aiding and abetting liability within § 20's civil remedies, Congress has expressly added aiding and abetting to several provisions governing SEC enforcement of the securities laws. The primary enforcement provision of the 1934 Act governing aiding and abetting is § 15(b), 15 U.S.C. § 78o(b) (1988). As amended, this section allows the SEC to censure or otherwise discipline any broker or dealer who:

has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any

<sup>15</sup> Occasionally, where Congress has known of a particular judicial interpretation of a statute and has chosen to re-enact the statute without change, such action has been considered evidence of Congress' approval of the interpretation. See, e.g., *Lorillard v. Pons*, 434 U.S. 575, 580-81 (1978). However, Congressional inaction cannot be so viewed where it has specifically been asked to incorporate the interpretation into the legislation and has rejected such requests. *T.I.M.E. Inc. v. United States*, 359 U.S. 464, 477-78 (1959); see also *Touche Ross*, 442 U.S. at 571 ("implying a private right of action on the basis of congressional silence is a hazardous enterprise, at best . . . [especially] where, as here, the plain language of the provision weighs against implication of a private remedy"). Thus, Congress' choice not to add aiding and abetting language to the 1934 Act's civil provisions negates any possible contention that it has endorsed a private right of action against aiders and abettors.

other person of any provision of the Securities Act of 1933, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, this title, the rules or regulations under any of such statutes, or the rules of the Municipal Securities Rulemaking Board.

15 U.S.C. § 78o(b)(4)(e) (1988). Congress incorporated this explicit aiding and abetting language into the SEC's disciplinary powers in 1964. Pub. L. No. 88-467, sec. 6(b), 78 Stat. 565, 571 (1964). This aiding and abetting language was added only to § 15, which concerns registration and regulation of brokers and dealers by the SEC and does not purport to create any private rights of action,<sup>16</sup> and was not added to § 10(b) or to any of the provisions of the 1934 Act creating private rights of action.

Several other provisions of the 1934 Act and related acts give the SEC or related regulatory bodies<sup>17</sup> further enforcement powers against aiders and abettors. Sections 15B and 15C of the 1934 Act, 15 U.S.C. §§ 78o-4, 78o-5 (1988), added in 1975 and 1986, respectively, empower the SEC to censure municipal or government securities brokers or dealers, or their associates, for violations of the provisions of § 15(b)(4)(E), which explicitly includes aiding and abetting. Under § 21B, 15 U.S.C. § 78u-2 (Supp. III 1991), passed in 1990, the SEC may impose civil penalties for violations of § 15(b)(4) or of §§ 15B or 15C. Under the Investment Advisers Act, the SEC has

<sup>16</sup> The majority of lower courts to analyze this section agree that none of the provisions of § 15 may be construed to create any private rights of action. See, e.g., *Asch v. Philips, Appel & Walden, Inc.*, 867 F.2d 776 (2d Cir. 1989), cert. denied, 493 U.S. 835 (1989); *Brannan v. Eisenstein*, 804 F.2d 1041, 1043 n.1 (8th Cir. 1986); *SEC v. Seaboard Corp.*, 677 F.2d 1301, 1313-14 & n.16 (9th Cir. 1982); Sally T. Gilmore & William H. McBride, *Liability of Financial Institutions for Aiding and Abetting Violations of Securities Laws*, 42 Wash. & Lee L. Rev. 811, 820 n.61 (1985) ("[c]ourts have rejected private aiding and abetting actions under Section 15") (citations omitted).

<sup>17</sup> Pursuant to § 19(h), 15 U.S.C. § 78s(h) (1988), a self-regulatory organization may suspend or expel any member or participant subject to an order under § 15(b)(4). Section 17A, 15 U.S.C. § 78q-1 (1988), grants the appropriate regulatory agency power to censure or discipline transfer agents or their associates for any violations of § 15(b)(4)(E), which expressly includes aiding and abetting.



authority to discipline any investment adviser who aids or abets violations of the securities laws. 15 U.S.C. § 80b-3(e)(5) (1988). The Commission may also obtain an injunction against any person who has aided or abetted or is about to aid or abet a violation of the Investment Advisers Act itself. 15 U.S.C. § 80b-9(d) (1988). Furthermore, under the Investment Company Act, the SEC may prevent any investment company or related organization from employing any person who has willfully aided or abetted a violation of the securities laws. 15 U.S.C. § 80a-9(b)(3) (1988).

Where one provision of the securities acts contains language which is not found in a second provision, the logical conclusion is that the language was intentionally left out of the second provision and should not be implied by the courts. *Touche Ross*, 442 U.S. at 571-72 (finding no implied private right of action under § 17(a), because Congress knew how to provide the private damage remedies it desired); *Ernst & Ernst*, 425 U.S. at 200-01 (use of different standards of scienter in the securities acts demonstrated that Congress did not intend a negligence standard for § 10(b)); *Blue Chip Stamps*, 421 U.S. at 733-34 (strict interpretation of "purchase or sale" requirement of § 10(b) supported by language of other securities provisions which reach fraud "in the offer or sale" of securities). Thus, the existence of aiding and abetting liability in other provisions of the 1934 Act strongly suggests that Congress has purposefully omitted such language from § 10(b) and from any express private rights of action.

"When Congress wished to provide a remedy" against aiders and abettors, "it had little trouble in doing so expressly." *Blue Chip Stamps*, 421 U.S. at 734. Congress has chosen to provide such a remedy within the 1934 Act only in the disciplinary context of SEC enforcement of various securities laws. Disregarding Congress' choice not to create private aiding and abetting liability under § 10(b) would endorse a dangerous and unwarranted expansion of the 1934 Act. "There has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps*, 421 U.S. at 739. Due to the

greatly expanded class of defendants who may be subjected to § 10(b) claims under an aiding an abetting regime, the right asserted by Respondents carries "[t]he same threats of speculative claims and procedural intractability" which the Court in the past has refused to countenance without strong evidence that the potential liability was intended by Congress. *Virginia Bankshares*, 111 S.Ct. at 2765.

### 3. Congress Has Specified What Secondary Liability It Intended To Create In Private Actions Under The 1934 Act.

"Those whose liabilities arise only because another has violated the law [are] called secondary wrongdoers." David S. Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy In Pari Delicto, Indemnification, and Contribution*, 120 U. Pa. L. Rev. 597, 600 (1972). Although Congress has chosen not to create a private right of action for aiding and abetting under the 1934 Act, it did impose another form of secondary liability, liability against controlling persons, in § 20(a) of the 1934 Act, 15 U.S.C. § 78t(a) (1988).<sup>18</sup> Both aiding and abetting and controlling person liability are means of creating a claim against a defendant based on the violation of a third party due to some link between the defendant and the third party's conduct. *See Fischel, supra*, at 80 n.4 (court-imposed aiding and abetting liability and controlling person liability under § 20(a) are two possible types of secondary liability under the 1934 Act). Under § 20(a) the link is provided by the control relationship between the defendant and the primary violator; in an aiding and abetting case the link is the substantial assistance by the aider and abettor in the achievement of the primary violation. Congress explicitly provided secondary liability against the defendant in the former case, but did not create secondary liability against aiders and abettors. Just as

<sup>18</sup> Respondents have not asserted a claim for controlling person liability against Central Bank, although they did bring such a claim against the director of the Developer. J.A. 3-27.



Congress knew how to impose aiding and abetting liability specifically when it wished to do so, it also knew how to impose liability derived from the conduct of another against a defendant in a private action. Congress has chosen not to impose such liability based on aiding and abetting.<sup>19</sup>

This Court most recently considered private rights of action under § 10(b) in *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 113 S. Ct. 2085 (1993). In that decision, the court described § 10(b) as one of the provisions of the 1934 Act which "impose[s] direct liability on defendants for their own acts as opposed to derivative liability for the acts of others." *Id.* at 2090. Under this view, § 10(b) does not give rise to any claim for aiding and abetting, since aiding and abetting is a form of secondary liability "imposed on defendants who have not themselves been held to have violated the express prohibition of the securities statute at issue, but who have some relationship with the primary wrongdoer." Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Cal. L. Rev. 80 n.4 (1981); see also Ruder, *supra*, at 620 (securities aiding and abetting cases impose a form of secondary liability).

By seeking to collect damages from Central Bank based upon a violation of § 10(b) allegedly committed by participants in the issuance of the 1988 Bonds, Respondents wish the Court to derive liability from the actions of a primary violator in much the same way that a court might under § 20(a). However, this Court concluded in *Musick* that §§ 9 and 18, not § 20, are the private rights in the 1934 Act most analogous to the implied right under § 10(b). The Court contrasted §§ 9 and 18, as well as § 10(b), which create direct liability, with § 20(a), which imposes derivative liability. *Musick*, 113 S. Ct. at 2090-91.

<sup>19</sup> The fact that Congress considered civil aiding and abetting liability as a proposed addition to § 20, see *supra* pp. 20-22, supports the conclusion that § 20 is the exclusive source of secondary liability in private actions under the 1934 Act.

The creation of derivative liability beyond that approved by Congress through the theory of aiding and abetting circumvents the boundaries Congress intended for derivative liability under the securities laws. For example, to establish aiding and abetting liability, a plaintiff is relieved of proving a control relationship between the defendant and the defrauder. Yet it is this relationship which places the defendant in a position to prevent the improper conduct of the primary violator and makes it reasonable to impose liability for failure to do so. Moreover, the statutory defense of § 20 that the controlling person "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action," 15 U.S.C. 78t (1988), is unavailable to aiding and abetting defendants. Thus, an implied aiding and abetting right would constitute an unwarranted expansion of the scope of derivative liability under the 1934 Act. "It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action." *Blue Chip Stamps*, 421 U.S. at 736 (footnote omitted).

As illustrated by this case, plaintiffs in securities fraud actions against controlling persons have taken to asserting aiding and abetting claims in addition to, or even instead of, controlling person claims, in the hopes of denying defendants the statutory defenses available in controlling person actions. Sally T. Gilmore & William H. McBride, 42 Wash. & Lee L. Rev. 811, 813-14 (1985). Such blatant attempts to avoid the parameters of derivative liability created by Congress cannot be countenanced. "[I]t is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it." *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 19 (1979). Congress' limitation of derivative liability under the 1934 Act to controlling persons belies any inference that it would have intended to impose § 10(b) liability in private actions against aiders and abettors.

**C. Judicial Creation Of A Private Right Of Action For Aiding And Abetting Violations Of Section 10(b) Improperly Applies Tort Law Concepts To Securities Law.**

Unlike aiding and abetting rights of action in favor of the SEC, which courts often consider analogous to criminal aiding and abetting, private aiding and abetting rights have been implied by courts primarily by looking to general tort law principles of aiding and abetting. However, this Court has disavowed reliance on tort law principles in implying rights under the securities acts. The Court should not acquiesce in a rule applied by lower courts which disregards fundamental principles of statutory interpretation laid down by this Court.

The origins of aiding and abetting liability are far removed from the securities context in which Respondents today ask the Court to apply it. Aiding and abetting has long been understood to create criminal accomplice liability. The concept of aiding and abetting has also been widely adopted by courts as a theory for imposing tort liability.

For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he

\* \* \*

(b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself, or

(c) gives substantial assistance to the other in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of duty to the third person.

*Restatement (Second) of Torts* § 876 (1977). This theory of tort liability has been applied primarily to tortious conduct resulting in physical harm.<sup>20</sup>

The one area outside of the realm of physical torts in which courts have frequently applied aiding and abetting

<sup>20</sup> Each of the sixteen illustrations to § 876 of the Restatement involves either physical harm to the plaintiff or destruction or burglary of his physical property.

liability is that of securities fraud, particularly in cases arising under § 10(b). See 4 Alan R. Bromberg & Lewis D. Lowenfels, *Securities Fraud & Commodities Fraud* § 8.5(614)(4), at 8:515 (1989) ("Apart from 10b-5 cases, Restatement sec 876 has been applied mainly to physical torts."). No lower court has declined to permit an implied private aiding and abetting right of action. However, although it has been increasingly questioned and criticized by certain lower courts<sup>21</sup> and by commentators,<sup>22</sup> very few decisions discuss in any detail the basis for an implied right of action for aiding and abetting under § 10(b). From those few that do, it appears that, unlike early SEC enforcement actions,<sup>23</sup> private aiding and abetting rights derive primarily from tort law. "The general statement of secondary liability appearing in

<sup>21</sup> See, e.g., *Akin v. Q-L Investments, Inc.*, 959 F.2d 521, 525 (5th Cir. 1992) ("There is a powerful argument that . . . aider and abettor liability should not be enforceable by private parties pursuing an implied right of action."); *Congregation of the Passion, Holy Cross Province v. Kidder Peabody & Co.*, 800 F.2d 177, 183 (7th Cir. 1986) ("We have frankly acknowledged that, in light of recent Supreme Court cases, there is some ambiguity about the existence of a civil cause of action for aiding and abetting a section 10(b) and Rule 10b-5 violation.") (footnotes omitted); *Little v. Valley Nat'l Bank*, 650 F.2d 218, 220 n. 3 (9th Cir. 1981) ("The status of aiding and abetting as a basis for liability under the securities laws is in some doubt."); *Benoy v. Decker*, 517 F. Supp. 490, 495 (E.D. Mich. 1981) ("It is also doubtful that a claim for 'aiding and abetting' or 'conspiracy' will continue to exist under 10(b). . . . [Ernst & Ernst] implicitly holds that aiding and abetting liability will not exist apart from liability for a direct violation. Recent commentary supports this view.") (citation and footnote omitted), *aff'd*, 735 F.2d 1363 (6th Cir. 1984).

<sup>22</sup> See, e.g., Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Cal. L. Rev. 80, 82 (1981) ("the theory of secondary liability is no longer viable in light of recent Supreme Court decisions strictly interpreting the federal securities laws"); Alan R. Bromberg & Lewis D. Lowenfels, *Aiding and Abetting Securities Fraud: A Critical Examination*, 52 Alb. L. Rev. 637, 651 (1988) (general criteria for implied private rights of action "weigh against an implied private action for aiding-abetting" under § 10(b) and Rule 10b-5).

<sup>23</sup> Courts have relied primarily upon criminal aiding and abetting in allowing the SEC to bring actions for aiding and abetting securities fraud, beginning with *SEC v. Timetrust, Inc.*, 28 F. Supp. 34, 43 (N.D. Cal. 1939) (applying criminal theory of aiding and abetting to an SEC enforcement action seeking injunctive relief because the suit was "similar in many respects to a criminal prosecution").

section 876 of the *Restatement of Torts* has been seized upon by some courts as providing a source of liability for secondary defendants." Ruder, *supra*, at 620 (footnote omitted); see also 5B Arnold S. Jacobs, *Litigation and Practice Under Rule 10b-5* § 40.02, at 2-417 to 2-418 (2d ed. 1991).

*Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970), is the first, and perhaps only, decision to attempt to rigorously justify the underpinnings of an implied § 10(b) aiding and abetting right of action. In creating such a right, *Brennan* made clear its heavy reliance upon section 876 of the *Restatement of Torts*. The court defended its use of the *Restatement* by asserting that "[a]ppropriate general principles of law should continue to guide the development of federal common law remedies under Section 10(b) and Rule 10b-5. . . . [Such principles] surely best fulfill the purposes of the Securities Exchange Act of 1934 and are a logical and natural complement" to the private right against primary violators. 259 F. Supp. at 680. Subsequent courts have continued to apply the *Restatement* concept of aiding and abetting to 10b-5 litigation, as illustrated by the elements required for § 10(b) aiding and abetting liability – (1) a securities law violation by the primary violator; (2) knowledge of the violation on the part of the aider and abettor; and (3) substantial assistance by the aider and abettor. *E.g.*, *K & S Partnership v. Continental Bank*, 952 F.2d 971, 977 (8th Cir. 1991), *cert. denied*, 112 S. Ct. 2993 (1992). These elements closely parallel the requirements for aiding and abetting liability under section 876(b) of the *Restatement*, that the defendant "knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself."

This reliance on general tort theory to imply a private right against aiders and abettors is no longer viable. This Court has resoundingly rejected application of general tort law principles to create private rights of action under the securities laws. In *Touche Ross & Co. v. Redington*, 442 U.S. 560, 568 (1979), the Court emphasized that the existence of a right of action under the securities laws is solely a question of

statutory construction and Congressional intent. An "argument in favor of implication of a private right of action based on tort principles, therefore, is *entirely misplaced*." *Id* (emphasis added); see also *Blue Chip Stamps*, 421 U.S. at 744-45 ("[T]he typical fact situation in which the classic tort of misrepresentation and deceit evolved was light years away from the world of commercial transactions to which Rule 10b-5 is applicable."); *Herman & MacLean*, 459 U.S. at 388 ("Reference to common-law practices can be misleading.").<sup>24</sup> Moreover, reliance upon this section of the *Restatement* is questionable in the securities context, which is very different from the context of physical torts for which the section was intended. "Since section 876 of the *Restatement of Torts* deals primarily with liability for physical harm rather than liability in the business or economic setting, it should be relied upon with caution in invoking securities law liability." Ruder, *supra*, at 621.

Because lower courts have developed a private right for aiding and abetting from general tort law principles, a practice this Court has since expressly disapproved, the Court should not acquiesce in the rule followed by the lower courts. Although the Court on other occasions had stated a willingness to recognize an implied private right of action which has gained acceptance in the lower courts, it has done so only when the right had already been tacitly accepted by the Court or its recognition was consistent with guiding principles previously provided by the Court. See, e.g., *Blue Chip Stamps*, 421 U.S. at 730 (implication of an implied private right of action against primary violators of § 10(b) by the lower courts "was, of course, entirely consistent with the Court's recognition in *J. I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964), that private enforcement of Commission rules may '[provide] a

<sup>24</sup> This view evidences the Court's evolution towards strict statutory construction and away from the concept embodied in *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964), that private rights in securities actions should be permitted whenever necessary to fulfill the general purposes of the securities acts. *Touche Ross*, 442 U.S. at 578; *Virginia Bankshares*, 111 S.Ct. at 2763. The logic of *Brennan* mirrors the outdated *J. I. Case* approach.



necessary supplement to Commission action.' "); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 380 (1982) (recognizing implied right under Commodity Exchange Act where, in prior decisions, "[t]his Court, as did other federal courts and federal practitioners, simply assumed that the remedy was available") (emphasis added); *Cannon v. University of Chicago*, 441 U.S. 677, 702-03 (1979) (recognizing implied right under Title IX for sex discrimination which had been persistently assumed by lower courts and was "even implicit in decisions of this Court") (emphasis added). In contrast, the Court has been careful not to endorse the lower courts' recognition of a private aiding and abetting right under § 10(b), *Ernst & Ernst*, 425 U.S. at 191 n.7; *Herman & MacLean*, 459 U.S. at 379, n.5, and implication of the right based on tort law concepts is emphatically not consistent with the Court's stated views of private rights under the securities acts. The Court is not bound to follow a rule created in the past by lower courts which is contrary to subsequent teachings of the Court.

Reliance upon tort law is also inappropriate because tort law in general, and aiding and abetting liability in particular, is an area traditionally relegated to states. *Cort v. Ash*, 422 U.S. 66, 78 (1975), has described one of the criteria of whether a private right of action should be implied as whether "the cause of action [is] one traditionally relegated to state law in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law." Since the common law rule of aiding and abetting stated in section 876 of the *Restatement* is normally a matter of concern in state tort law, it does not appropriately give rise to an implied federal right of action. Bromberg & Lowenfels, 52 Alb. L. Rev. at 657. Furthermore, aiding and abetting improper sales of securities has traditionally been a concern of state blue sky laws, which also brings such claims within the scope of a traditional area of state law. *Id.* at 659.<sup>25</sup>

<sup>25</sup> For example, aiders and abettors of securities frauds are subject to statutory civil liability in Colorado. Colo. Rev. Stat. § 11-51-604(5)(c) (Supp. 1992).

This criterion from *Cort v. Ash* thus weighs against implying a private right of action for aiding and abetting under § 10(b).<sup>26</sup>

Application by this Court of the tort concept of aiding and abetting to § 10(b) would be an unwarranted extension of private civil liability. Whereas the implied private right under § 10(b) endorsed by the Court in the past merely expands the class of plaintiffs who may sue violators of § 10(b), aiding and abetting creates an entirely new category of defendants who may be held jointly and severally liable for damages resulting from the primary violation of another. The statute provides no justification for subjecting such a class of defendants to potential securities liability, especially where the right improperly originates from tort theory and where Congress purposefully restricted aiding and abetting under the 1934 Act to disciplinary actions by the SEC. Therefore, the Court should affirm the district court's grant of summary judgment in favor of Central Bank.

## II. CENTRAL BANK MAY NOT BE HELD LIABLE TO RESPONDENTS BASED ON MERE RECKLESSNESS, BECAUSE ACTUAL KNOWLEDGE OR CONSCIOUS INTENT IS REQUIRED TO SATISFY THE SCIENTER REQUIREMENT FOR AIDING AND ABETTING VIOLATIONS OF SECTION 10(b) AND RULE 10b-5 ABSENT A DUTY TO DISCLOSE OR TO ACT.

Even if a private right of action exists against defendants for aiding and abetting violations of § 10(b) or Rule 10b-5, such a right cannot extend to Central Bank in this case.

Both the district court and the court of appeals determined that Central Bank, whose duties as indenture trustee were strictly limited to those specified in the Indenture, did not owe a duty to disclose to Respondents. J.A. 203. The court of appeals made no finding that Central Bank had failed to meet any of its duties as trustee and did not reach the

<sup>26</sup> Each of the other four factors identified in *Cort v. Ash* are addressed by the above discussion of Congressional intent, *Touche Ross*, 442 U.S. at 575-76, and also weigh against recognition of an implied private right.

question of whether Central Bank had knowledge of the alleged fraud, holding instead that Central Bank could be liable as an aider and abettor to the alleged securities fraud if it recklessly<sup>27</sup> provided assistance by action. J.A. 210. The court embraced the Ninth Circuit's minority view that recklessness may satisfy the requirement of scienter in a § 10(b) aiding and abetting case even if the defendant had no duty to disclose or act, and went even beyond the Ninth Circuit's position, which requires some actual misrepresentation by the defendant, by holding that recklessness suffices whenever the defendant has taken any affirmative action. This rule utterly disregards the crucial requirement in any 10(b) case of manipulative or deceptive conduct by the defendant. The court of appeals eschewed the rule followed by the majority of courts, which recognizes that recklessness cannot be considered a form of deceptive conduct where there is no duty owed by the defendant. The approach of the court below does not provide a workable standard for aiding and abetting liability and would invite litigation against a host of defendants § 10(b) was never intended to reach.

**A. No Action Under Section 10(b) Or Rule 10b-5 May Be Maintained Without Proof Of Manipulative Or Deceptive Conduct By The Defendant.**

In determining the scienter requirement in any § 10(b) or Rule 10b-5 case, "the starting point for our inquiry is *Ernst & Ernst v. Hochfelder* . . . Although the issue presented in the present case was expressly reserved in *Hochfelder*, we nonetheless must be guided by the reasoning of that decision." *Aaron v. SEC*, 446 U.S. 680, 689-90 (1980) (citation omitted). As was the case in *Aaron*, the Court declined to rule on the present issue in *Ernst & Ernst*. The Court reserved the question of "whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b-5,"

<sup>27</sup> The court defined recklessness as "conduct that is 'an extreme departure from the standards of ordinary care, and which presents a danger . . . that is either known to the defendant or is so obvious that the actor must have been aware of it.'" J.A. 210 (quoting *Hackbart v. Holmes*, 675 F.2d 1114, 1118 (10th Cir. 1982)).

425 U.S. at 193 n.12, and further reserved the question of what elements are necessary to establish a civil aiding and abetting claim if such a claim is appropriate. 425 U.S. at 191 n.7; see also *Herman & MacLean*, 459 U.S. at 378 n.4; *Aaron*, 446 U.S. at 686 n.5. Nevertheless, as was true in *Aaron*, "the rationale of *Hochfelder* ineluctably leads to the conclusion" that the scienter rule advanced by Respondents is inadequate to meet the requirements of § 10(b). 446 U.S. at 691.

In *Ernst & Ernst v. Hochfelder*, the Court rejected the view held by many of the courts of appeals at that time that civil liability under § 10(b) could be based only on negligence. See, e.g., *White v. Abrams*, 495 F.2d 724, 730 (9th Cir. 1974); *Myzel v. Fields*, 386 F.2d 718, 735 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968); *Kohler v. Kohler Co.*, 319 F.2d 634, 637 (7th Cir. 1963). In response to the SEC's position that a negligence rule would best further the Congressional purpose of protecting investors,<sup>28</sup> the Court stated:

[A]part from where its logic might lead, the Commission would add a gloss to the operative language of the statute quite different from its commonly accepted meaning. The argument simply ignores the use of the words 'manipulative,' 'device,' and 'contrivance' — terms that make unmistakable a congressional intent to proscribe a type of conduct quite different from negligence. Use of the word 'manipulative' is especially significant. It is and was virtually a term of art when used in connection with securities markets. It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.

<sup>28</sup> Although the Commission endorsed a negligence standard in *Ernst & Ernst*, it suggested that certain additional requirements be imposed before negligence would be considered sufficient, including that the defendant knew or could foresee that the plaintiff would rely on his conduct. 425 U.S. at 198 n.18. This added requirement is functionally similar to the majority rule's requirement of a duty to disclose or act before recklessness liability may be imposed in an aiding and abetting case. See Section II.B.1., *infra*.

425 U.S. at 198-99 (citation and footnotes omitted). The use of such strong language in § 10(b) compelled the Court's conclusion that § 10(b) "clearly connotes intentional misconduct" by the defendant. *Id.* at 201.

The requirement is not obviated by a defendant's status as an aider and abettor rather than the primary violator. The aider and abettor, like any § 10(b) defendant, must be guilty of some sort of "intentional misconduct." *Id.* This requirement adheres to the standard for aiding and abetting endorsed by this Court in the criminal context in *Nye & Nissen v. United States*, 336 U.S. 613, 619 (1949). There the Court adopted Judge Learned Hand's view of aiding and abetting stated in the seminal case of *United States v. Peoni*, 100 F.2d 401 (2d Cir. 1938). Reviewing the various existing definitions of accomplice liability, Judge Hand concluded that aiding and abetting requires that the defendant "in some sort associate himself with the venture, that he participate in it as in something that he wishes to bring about, that he seek by his action to make it succeed. All the words used – even the most colorless, 'abet' – carry an implication of purposive attitude towards it." *Id.* at 402.<sup>29</sup>

Whereas the requirement of willful conduct contained in *Ernst & Ernst* echoes the *Peoni* scienter standard, the court below has entirely abandoned Judge Hand's conception of aiding and abetting liability. Relying solely on a tenuous distinction between action and inaction, the court of appeals has allowed an aiding and abetting claim against Central Bank to proceed without any evidence that Central Bank engaged in any intentional or deceptive conduct, that it knew of or intended to further the alleged primary fraud, or that it had any duty to discover or disclose the primary fraud. Imposition of liability against Central Bank in these circumstances cannot be reconciled with the crucial requirement under § 10(b) of manipulative or deceptive conduct by the defendant.

<sup>29</sup> The Model Penal Code similarly requires a "purpose of promoting or facilitating the commission of an offense." *Model Penal Code* § 2.06(3)(a) (1962).

Certainly Central Bank was not a party to any manipulation, a "term of art" which "refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 476 (1977) (citations omitted); see also *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 7-8 (1985). The court below offered no explanation as to how Central Bank's conduct might be considered deceptive where it owed no duty to Respondents. The more logical view, embraced by most lower courts, is that reckless conduct by a defendant is not deceptive where, as here, there is no underlying relationship giving rise to a duty owed by the defendant to the plaintiff.

**B. Because It Did Not Owe A Duty To Disclose Or To Act, Central Bank Engaged In No Deceptive Conduct Where It Committed No Independent Fraudulent Acts And Where It Had No Actual Knowledge Of Or Conscious Intent To Further The Fraudulent Act Of Another.**

In contrast to the court below, the great majority of the courts of appeals impose liability for aiding and abetting based on recklessness only in situations where recklessness may reasonably be deemed a type of deceptive conduct under § 10(b). While any aiding and abetting theory is inherently at odds with the "manipulative or deceptive" requirement of § 10(b) as explained by *Ernst & Ernst*, see Section I.A., *supra*, most courts at least attempt to restrict aiding and abetting liability to conduct of an arguably manipulative or deceptive nature. The majority of the circuits require actual knowledge of the fraud or conscious intent to further the fraud where the defendant owed the plaintiff no affirmative duty to act or disclose. The Seventh Circuit requires an independent fraudulent act by the aider and abettor. Neither of these rules would permit an aiding and abetting claim against Central Bank.



**1. The Scienter Standard Applied By Most Courts, Which Requires Actual Knowledge Or Conscious Intent For Aiding And Abetting Liability Absent A Duty To Disclose Or To Act, Would Not Permit Liability Against Central Bank.**

The courts of appeals uniformly require three elements for aiding and abetting a § 10(b) violation: "(1) the existence of a securities law violation by the primary (as opposed to the aiding and abetting) party; (2) 'knowledge' of this violation on the part of the aider and abettor; and (3) 'substantial assistance' by the aider and abettor in the achievement of the primary violation." *E.g.*, *IIT v. Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980). The Second, Third, Fourth, and Eighth Circuits use this test essentially verbatim. *See, e.g., id.*; *Landy v. FDIC*, 486 F.2d 139, 162-63 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974); *Schatz v. Rosenberg*, 943 F.2d 485, 495 (4th Cir. 1991), *cert. denied*, 112 S. Ct. 1475 (1992); *Metge v. Baehler*, 762 F.2d 621, 624 (8th Cir. 1985), *cert. denied*, 474 U.S. 1057 (1986). A variant of the test restates the second and third elements as "the defendant's general awareness that his role was part of an overall activity that is improper" as well as "knowing and substantial assistance." *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983). The District of Columbia, First, Fifth, Sixth, and Eleventh Circuits use this language. *See, e.g., id.*; *Investors Research Corp. v. SEC*, 628 F.2d 168, 178 (D.C. Cir. 1982), *cert. denied*, 449 U.S. 919 (1980); *Fine v. American Solar King Corp.*, 919 F.2d 290, 300 (5th Cir. 1990), *cert. dismissed*, 112 S. Ct. 576 (1991); *Moore v. Fenex, Inc.*, 809 F.2d 297, 303 (6th Cir. 1987), *cert. denied*, 483 U.S. 1006 (1987); *Woods v. Barnett Bank of Fort Lauderdale*, 765 F.2d 1004, 1009 (11th Cir. 1985). As will be seen, the two variations of the majority test do not lead to markedly different results.

The requirement of knowledge of the fraud is intended to meet the scienter standard of *Ernst & Ernst*. Rather than attempt to interpret this element according to a bright-line rule, most courts conform to a variable scienter test. Joel S. Feldman, *The Breakdown of Securities Fraud Aiding and*

*Abetting Liability: Can a Uniform Standard Be Resurrected?*, 19 Sec. Reg. L. J. 45, 53-57 (1991) (describing in detail scienter requirement employed by majority of circuits). Under the majority's approach, the scienter requirement increases from recklessness to either actual knowledge of the fraud or conscious intent to further the fraud where the defendant owed the plaintiff no duty to disclose or act.<sup>30</sup> The First,<sup>31</sup> Second,<sup>32</sup> Third,<sup>33</sup> Fourth,<sup>34</sup>

<sup>30</sup> Whether actual knowledge or conscious intent is required is generally determined by whether the defendant assisted by action or inaction. *Id.* In light of the Court's language in *Ernst & Ernst*, the better view is that conscious intent is necessary without regard to the defendant's action or inaction. Whichever approach is adopted by the Court, the decision below was improper since the Tenth Circuit required recklessness only.

<sup>31</sup> *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983) ("Courts generally have held that in the absence of a duty of disclosure, a defendant should be held liable as an aider and abettor only if the plaintiff proves that the defendant had actual knowledge of the improper activity of the primary violator and of his role in that activity. *Woodward v. Metro Bank of Dallas*, 522 F.2d at 96.") (additional citations omitted).

<sup>32</sup> *Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir. 1983) ("[I]f the alleged aider and abettor owes a fiduciary duty to the plaintiff, recklessness is enough. If there is no fiduciary duty, the 'scienter' requirement scales upward - the assistance rendered must be knowing and substantial.") (citations omitted); *see also Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990); *National Union Fire Ins. Co. v. Turtur*, 892 F.2d 199, 206-07 (2d Cir. 1989); *IIT v. Cornfeld*, 619 F.2d 909, 923-25 (2d Cir. 1980); *Edwards & Hanly v. Wells Fargo Sec. Clearance Corp.*, 602 F.2d 478, 484-85 (2d Cir. 1979), *cert. denied*, 444 U.S. 1045 (1980); *Rolf v. Blyth, Eastman, Dillon & Co.*, 570 F.2d 38, 44-45 (2d Cir. 1978), *cert. denied*, 439 U.S. 1039 (1978).

<sup>33</sup> *Walck v. American Stock Exch., Inc.*, 687 F.2d 778, 791 (3d Cir. 1982) ("With no allegation that the Exchanges had actual knowledge of E&H's conduct in violation of § 10(b) and Rule 10b-5 leading to the plaintiffs' purchases of Trans-Lux stock, the complaint fails to allege the existence of the elements necessary for relief under a theory of aiding and abetting an independent violation of the law."), *cert. denied*, 461 U.S. 942 (1983); *see also Monsen*, 579 F.2d at 799-800; *Rochez Bros. v. Rhoades*, 527 F.2d 880, 886-87 (3d Cir. 1975); *Landy v. FDIC*, 486 F.2d 139, 162-64 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

<sup>34</sup> *Schatz v. Rosenberg*, 943 F.2d 485, 496 (4th Cir. 1991) ("[A]n evaluation of the 'knowledge' requirement of the aiding and abetting liability test turns upon whether the aider and abettor defendant owed a duty to the plaintiff. When there is no duty running from the alleged aider and abettor to the plaintiff, the defendant must possess a 'high conscious intent' and a 'conscious and specific motivation' to

Fifth,<sup>35</sup> Eighth,<sup>36</sup> and Eleventh<sup>37</sup> Circuits have each held in accordance with the majority rule that where the defendant owes no duty, either actual knowledge or conscious intent to further the fraud, depending upon the circumstances, is required.<sup>38</sup> The District of Columbia and Sixth Circuits have not yet had the opportunity to so hold, but language in certain of their decisions is consistent with the majority view.<sup>39</sup>

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aid the fraud.") (citing *IIT*, 619 F.2d at 925; *Woodward*, 522 F.2d at 97), cert. denied, 112 S. Ct. 1475 (1992).

<sup>35</sup> *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 97 (5th Cir. 1975) ("When it is impossible to find any duty of disclosure, an alleged aider-abettor should be found liable only if scienter of the high 'conscious intent' variety can be proved."); see also *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1126-27 (5th Cir. 1988), cert. denied, 492 U.S. 918 (1989), and vacated on other grounds sub nom. *Fryar v. Abell*, 492 U.S. 914 (1989).

<sup>36</sup> *Camp v. Dema*, 948 F.2d 455, 462 (8th Cir. 1991) ("Because Kidder did not owe Camp a duty to disclose, the knowledge requirement may not be satisfied by recklessness."); see also *K & S Partnership v. Continental Bank*, 952 F.2d 971, 978 (8th Cir. 1991), cert. denied, 112 S. Ct. 2993 (1992); *Metge v. Baehler*, 762 F.2d 621, 625 (8th Cir. 1985), cert. denied, 474 U.S. 1057 (1986).

<sup>37</sup> *Woods v. Barnett Bank of Fort Lauderdale*, 765 F.2d 1004, 1010 (11th Cir. 1985) ("A defendant who is not under any duty to disclose can be found liable as an aider and abettor only if he acts with a high degree of scienter, that is, with a 'conscious intent' to aid the fraud.").

<sup>38</sup> This variable scienter standard is most commonly referred to as the "sliding scale" test. See Feldman, *supra*. This term has also at times been used to describe the related concepts advanced by certain courts that conscious intent is required despite actions taken by the defendant where the actions occur in the course of ordinary business transactions, e.g., *Camp*, 948 F.2d at 464; *Schatz*, 943 F.2d at 497; *Monsen*, 579 F.2d at 799 n.9, and that the level of evidence required to prove actual knowledge may increase where the defendant's participation in the alleged wrongdoing is less substantial. E.g., *Schneberger v. Wheeler*, 859 F.2d 1477, 1480-81 (11th Cir. 1988). To avoid any ambiguity, the term "majority rule" is used in this brief to convey the aspect of the sliding scale test pertinent here, that recklessness is not adequate scienter where the defendant owes no duty to disclose or to act.

<sup>39</sup> See *Dirks v. SEC*, 681 F.2d 824, 825 n.28 (D.C. Cir. 1982) (extraordinary degree of scienter not necessary where defendant owed a duty to the public and knew of fraudulent transactions), rev'd on other grounds, 463 U.S. 646 (1983); *SEC v. Washington County Util. Dist.*, 676 F.2d 218, 226 (6th Cir. 1982) (less evidence of knowledge necessary where defendant owed a fiduciary duty).

The scienter standard employed by the majority of the courts of appeals allows liability based upon recklessness, while at the same time attempting to adhere to the scienter requirements of *Ernst & Ernst*. Unless *Ernst & Ernst*'s teachings as to the purpose of § 10(b) are to be entirely abandoned, recklessness can be sufficient only where there is some legitimate basis for considering the reckless conduct to be akin to "a manipulative or deceptive device or contrivance." The majority rule's requirement of actual knowledge or conscious intent in the absence of a duty to disclose or act seeks to provide this basis.<sup>40</sup> This Court has recognized in the securities context that conduct which would otherwise not be actionable can rise to the level of fraud where the defendant owed some sort of duty, particularly a disclosure duty, to the plaintiff. In *Chiarella v. United States*, 445 U.S. 222 (1980), the Court held that silence in connection with the purchase or sale of a security can be deemed fraudulent conduct only if the defendant owed a pre-existing disclosure duty. Simply put, "[w]hen an allegation of fraud is based upon non-disclosure, there can be no fraud absent a duty to speak." *Id.* at 235. A duty to speak is thus of obvious significance in interpreting the antifraud provisions of the securities laws, which "are directed at failures to disclose." *Schreiber*, 472 U.S. at 8.

The majority rule proceeds from this simple premise. Recklessness may assume a character of deception where the defendant owes an affirmative duty, just as silence may become deceptive where there is a duty to disclose. "To be actionable, of course, a statement must also be misleading. Silence, *absent a duty to disclose*, is not misleading under Rule 10b-5." *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (1988) (emphasis added). Silence does not work deception upon another unless a relationship exists such that one is

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<sup>40</sup> Thus, while the majority rule does not follow a strict reading of *Ernst & Ernst*, which would require conscious intent without regard to any disclosure duties, it at least bears some relationship to the "manipulative or deceptive" requirement of *Ernst & Ernst* and § 10(b), unlike the Tenth Circuit's new standard. See Section II.C.1., *infra*.



expected to speak. By the same token, recklessness is misleading or deceptive only where there is some relationship which reasonably created in another person the expectation that the reckless party would take steps to protect that person's interests. Such an expectation is reasonable where there was a preexisting duty to disclose or act. The majority rule, by its requirement of a duty to disclose or act, therefore, attempts to ensure that liability will be imposed only where the reckless conduct could legitimately be deemed a type of manipulative or deceptive practice.

In this matter, the majority rule would not permit aiding and abetting liability against Central Bank without evidence of actual knowledge of the alleged fraud or conscious intent to further the fraud, because the bank did not owe any duty to Respondents under the circumstances. Central Bank's conduct of delaying its demand for an independent appraisal was discretionary and was not in disregard of any duty owed.<sup>41</sup> With hindsight, Respondents now criticize the timing of Central Bank's decision but cannot claim to have been deceived by such action, which the Indenture clearly disclosed beforehand as an option of the trustee. The mere fact that actions taken by a party may in other contexts be considered reckless does not in any way render the conduct manipulative or deceptive under § 10(b), any more than actions which rise to the level of ordinary negligence may be considered deceptive. See *Ernst & Ernst*, 425 U.S. at 214.

By requiring actual knowledge or conscious intent before aiding and abetting liability may be imposed in the absence of a duty to disclose or to act, the majority rule applies a scienter standard which at least attempts to follow the "manipulative or deceptive" language of § 10(b) and the teachings of *Ernst*

<sup>41</sup> Under the Indenture, the Trustee has "the right, but shall not be required, to demand any . . . appraisals . . . deemed desirable for the purpose of . . . any other action by the Trustee." Indenture, § 9.01(k). The discretion to delay exercising a right, or to forego it altogether, is likewise protected by the Indenture: "The permissive right of the Trustee to do things enumerated in this Indenture shall not be construed as a duty . . ." Indenture, § 9.01(g). See J.A. 143-45.

& *Ernst*. Under this standard, Central Bank may not be liable under § 10(b) for reckless aiding and abetting.

## 2. The Seventh Circuit Aiding And Abetting Standard, Which Requires A Manipulative Or Deceptive Act By The Defendant, Also Would Not Permit Aiding And Abetting Liability Against Central Bank.

The Seventh Circuit goes even beyond the majority rule by requiring, in addition to the three elements listed above, that an aider and abettor must have "himself committed one of the 'manipulative or deceptive' acts or otherwise met the standards of direct liability (save for the fact that he did not offer or sell the securities)." *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495 (7th Cir. 1986). Plaintiffs have not even alleged that Central Bank's conduct meets the standards for a primary violation of § 10(b). Since Central Bank here is charged only with recklessly assisting fraudulent conduct, rather than itself committing a fraudulent act, it could not be held liable under this test.

In the *Barker* case, Judge Easterbrook prefaced the Seventh Circuit's rule with a discussion of the need to adhere to *Ernst & Ernst*'s conception of § 10(b). "A court must take care lest the implied right of action under Rule 10b-5 unravel the presumptions and defenses created by Congress." *Id.* In the later case of *Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1126 (7th Cir. 1990), *cert. denied*, 111 S.Ct. 1317 (1991), the court defended a strict intent standard by observing that "it is the intent requirement that distinguishes an action for securities fraud from an action for negligence or malpractice."

At the time of *Ernst & Ernst*, the Court was already concerned with suggested standards of liability which "would significantly broaden the class of plaintiffs who may seek to impose liability upon accountants and other experts who perform services or express opinions with respect to matters under the Acts." 425 U.S. at 214 n.33. If aiding and abetting claims are deemed appropriate under § 10(b), yet unwarranted expansion of civil liability under § 10(b) continues to be a concern of the Court, the Seventh Circuit aiding and abetting



standard, which is calculated to remain faithful to the analysis of *Ernst & Ernst*, is a logical alternative.

**C. By Allowing Aiding And Abetting Liability Based On Recklessness Whenever There Is Assistance By Action, The Court Of Appeals Fails To Require Manipulative Or Deceptive Conduct And Creates An Unworkable Scierter Standard.**

Although conceding that some courts have held "that recklessness is not sufficient scierter for aiding-and-abetting liability unless the defendant has a fiduciary duty," J.A. 206 (citations omitted), the court of appeals chose not to follow this majority rule and instead held that "in an aiding-and-abetting case based on assistance by action, the scierter element is satisfied by recklessness." J.A. 210. This action-inaction dichotomy, permitting liability based on recklessness whenever the defendant has taken some affirmative act, apparently originated in the Ninth Circuit,<sup>42</sup> although even the Ninth Circuit has not held that *any* action by the defendant reduces the scierter standard to recklessness. See *Levine v. Diamantheset, Inc.*, 950 F.2d 1478, 1484 n.4 (1991) (court need not consider whether defendant has a duty to disclose where aiding and abetting liability is premised on actual

<sup>42</sup> The court of appeals also purported to rely on the Eighth Circuit's opinion in *FDIC v. First Interstate Bank*, 885 F.2d 423, 432-33 (8th Cir. 1989). In that case the court found that the defendant *did* have a duty to disclose and could therefore be held liable for aiding and abetting based on recklessness. *Id.* at 433. The court went on to note that because the claims against the defendant were not based only on inaction, plaintiff did not need to show that the defendant consciously intended to defraud. *Id.* This merely follows the rule under the majority's sliding scale that conscious intent is required only in cases based on inaction. See *supra* n.30. Subsequent decisions confirm that the Eighth Circuit did not abandon the majority rule in its *FDIC* opinion. See *K & S Partnership v. Continental Bank*, 952 F.2d 971, 978 (8th Cir. 1991) (quoting proposition from *Woodward* that "[w]hen it is impossible to find any duty of disclosure, an alleged aider-abettor should be found liable only if scierter of the high 'conscious intent' variety can be proved"), *cert. denied*, 112 S.Ct. 2993 (1992); *Camp v. Dema*, 948 F.2d 455, 462 (8th Cir. 1991) ("Because Kidder did not owe Camp a duty to disclose, the knowledge requirement may not be satisfied by recklessness. See *FDIC*, 885 F.2d at 432-33.").

misrepresentations rather than silence).<sup>43</sup> The scierter test utilized by the court below disregards the requirement emphasized in *Ernst & Ernst* of manipulative or deceptive conduct, instead relying on an unworkable and conceptually flawed distinction.

**1. The "Assistance By Action" Rule Utilized By The Court Of Appeals Is Unrelated To The Scierter Requirement Identified In *Ernst & Ernst*.**

For guidance as to the appropriate standard of scierter, both the Ninth Circuit and the court below look simply to whether the defendant took some affirmative action in its role as aider and abettor. By discarding the majority rule's initial inquiry as to the defendant's duty to disclose or act, this minority rule ignores the course charted by this Court in *Ernst & Ernst*, by which courts must look to the deceptiveness of the defendant's conduct with respect to the plaintiff, and deviates even further from Judge Hand's traditional view of the aider and abettor as one who actively seeks to bring about the unlawful result.

As seen above, where the defendant owes some duty to the plaintiff, reckless acts which otherwise would not be actionable under the securities laws may fairly be regarded as of a deceptive nature. Conduct of the defendant may assume an additional misleading quality where he knows he is subject to a disclosure duty. *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (1988). There is no analogous basis for deeming a defendant to be guilty of deception or manipulation based on reckless actions where a reckless failure to act by the same defendant would not be considered manipulative or deceptive. As interpreted by *Ernst & Ernst*, § 10(b) contains a strict requirement as to the defendant's state of mind. Yet the

<sup>43</sup> Under the majority rule, a duty to disclose or to act is required to impose liability even for an aider and abettor's reckless misrepresentations. See, e.g., *Ross*, 904 F.2d at 822, 824 (defendant clearing agent allegedly misrepresented brokerage firm's solvency; court held recklessness insufficient for aiding and abetting liability absent any fiduciary duty); *ITT*, 619 F.2d at 923-24 (underwriter defendants circulated prospectus containing misrepresentations; court held recklessness satisfied scierter requirement where defendants owed plaintiffs a fiduciary duty).

defendant's state of mind is no different whether he assists the fraud by action or inaction.

Moreover, the rule utilized by the court below requires less than even the Ninth Circuit's approach. The Ninth Circuit has reduced the scienter requirement to recklessness based on affirmative actions only where the actions constitute "actual misrepresentations." *Levine*, 950 F.2d at 1484 & n.4 (finding especially significant the fact that defendant trust company issued deceptive confirmations to investors). Thus, even the Ninth Circuit at least searches for some conduct of a deceptive nature. The court below recognized no such limitation, deeming recklessness sufficient in any "aiding-and-abetting case based on assistance by action." J.A. 210.

The failure of the Tenth Circuit's new standard to adhere to the *Ernst & Ernst* scienter requirement is amply illustrated by this very case. The court of appeals stressed that Respondents' claim against Central Bank was not based only on inaction, but also on the allegation "that Central Bank assisted the primary violation by affirmative action, specifically by affirmatively agreeing to delay the independent review of the Hastings appraisal." J.A. 207. Yet it was Central Bank itself which, as Trustee, exercised its discretion and initially requested an independent review of the appraisal. If Central Bank had simply ignored the concerns raised about the appraisal and had never requested such a review, the case would have been one of inaction and liability could not be imposed based on mere recklessness even under the minority rule. Yet Central Bank's state of mind would be unchanged in the latter case. The court of appeals' "assistance by action" rule is therefore impermissibly divorced from any reasonable evaluation of scienter.

## 2. The "Assistance By Action" Rule Does Not Provide A Workable Standard For Determining The Requisite Scienter For Aiding And Abetting A Violation Of Section 10(b) Or Rule 10b-5.

The court of appeals' "assistance by action" scienter standard proceeds solely from the distinction between action

and inaction, a distinction which is hopelessly blurred in many aiding and abetting cases. To focus solely on whether the defendant took some affirmative action in assisting the primary violator is to invite confusion and inconsistent results in this area of the law. By definition, the aider and abettor is not the party which committed the acts constituting the primary violation of § 10(b).<sup>44</sup> Conversely, one can imagine only with difficulty an entity substantially assisting a fraud and becoming implicated as an aider and abettor without undertaking any affirmative conduct whatsoever. The conduct of any aider and abettor must be expected to defy ready categorization as action or inaction. At best, "[t]he distinction between positive action and deliberate inaction is elusive." *Metge v. Baehler*, 762 F.2d 621, 624 (8th Cir. 1985), *cert. denied*, 474 U.S. 1057 (1986).

Again the Court need look no further than the instant case for an illustration of the insubstantial character of the court of appeals' "assistance by action" standard. The conduct characterized by the Respondents and the Tenth Circuit as affirmative action by reason of Central Bank's agreement to delay the independent review of the appraisal can also fairly be described as inaction, *i.e.*, Central Bank's failure to insist upon an independent review before the 1988 Bonds were issued. It is evident that a case which would ordinarily be considered to arise from the defendant's inaction may easily be couched in terms of "assistance by action" by a plaintiff or even a court so inclined.<sup>45</sup> A reliable scienter test cannot be founded solely on this tenuous, subjective standard.

<sup>44</sup> As explained above, only in the Seventh Circuit is the aider and abettor expected himself to "commit one of the 'manipulative or deceptive' acts prohibited under section 10(b) and rule 10b-5." *Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1123 (7th Cir. 1990), *cert. denied*, 111 S.Ct. 1317 (1991); see Section II.B.2., *supra*.

<sup>45</sup> Several cases decided in other circuits which the courts analyzed as based on inaction likely would be deemed affirmative action cases under the Tenth Circuit's loose standard. See, *e.g.*, *Metge*, 762 F.2d at 623-24 (defendant was "heavily involved" in financing primary violator and engaged in various strategies to keep it in business, yet court characterized its involvement as inaction); *ITT*, 619 F.2d at 925-27 (focusing on whether "mere inaction" could give rise to aiding and abetting claim, where defendant accountant audited and certified allegedly inaccurate financial statements).



Furthermore, such facile categorizations of action and inaction will invariably subject banks, accountants, lawyers or other professionals who "assist" in a purchase or sale of securities to liability under a recklessness standard with no analysis of whether the conduct transgressed a duty owed to the plaintiffs. As stated by the court of appeals: "the *Levine* court considered the case before it as one based upon assistance by action and for that reason expressly found irrelevant the question whether the alleged aiders-and-abettors had a duty to disclose." J.A. 208. While the majority position considers the duty question in an attempt to ensure that the conduct of the alleged aider and abettor at least had the characteristics of deception, the court of appeals simply abandons the inquiry in favor of a *per se* rule equating reckless, affirmative action with deception. The practical effect of this approach on Central Bank and others assisting in such transactions is to bootstrap a duty where none exists as a matter of state law, contrary to this Court's decision in *Chiarella v. United States*, 445 U.S. 222 (1980), and to create an unwarranted presumption that the alleged aider and abettor intended to defraud the plaintiff simply because its conduct was later judged as reckless.

**D. A Recklessness Standard Divorced From Any Duty To Disclose Or To Act Would Invite Unduly Expanded Section 10(b) Litigation Against A Host Of Legitimate Business Entities.**

Finally, the Court must consider the impact a ruling affirming the Tenth Circuit's standard of recklessness based upon affirmative action would have. The Court has traditionally been wary of expanding potential claims under § 10(b). *Ernst & Ernst*, 425 U.S. at 214 n.33. It has observed that there is a heightened danger of vexatious litigation in the § 10(b) arena, *Blue Chip Stamps*, 421 U.S. at 739, and has

concluded that it is best left to Congress to determine when an expansion of private litigants' rights under the securities laws is warranted. *Touche Ross*, 442 U.S. at 579.

These concerns must carry particular weight in the aiding and abetting context of the present litigation. Any expansion of private aiding and abetting rights of action under § 10(b) can affect uncounted professionals and business entities, particularly banks, accountants, and securities lawyers who participate in purchases or sales of securities. Where the expansion takes the form of a relaxation of the requirement of scienter, the potential for new liability among these groups is especially significant. The potential liability against a bank in the present case calls to mind Professor Ruder's concern regarding the potential impact of § 10(b) aiding and abetting liability against banks where knowledge is not required:

Imposition of such liability upon banks would virtually make them insurers regarding the conduct of insiders to whom they loan money. If it is assumed that an illegal scheme existed and that the bank's loan or other activity provided assistance to that scheme, some remaining distinguishing factor must be found in order to prevent such automatic liability. The bank's knowledge of the illegal scheme at the time it loaned the money or agreed to loan the money provides that additional factor. *Knowledge of wrongful purpose thus becomes a crucial element in aiding and abetting or conspiracy cases.*

Ruder, *supra*, at 630-31 (emphasis added). It is this requirement of knowledge of wrongful purpose which Respondents ask this Court to dramatically reduce, even below the fairly permissive standard followed by the majority of the courts of appeals.

Relaxation of the scienter requirement in § 10(b) aiding and abetting cases can generate such dramatic impact because of the nature of the § 10(b) provision. In comparison to other securities provisions, "§ 10(b) is a 'catchall' antifraud provision, but it requires a plaintiff to carry a heavier burden to establish a cause of action." *Herman & MacLean*, 459 U.S. at



382 (footnote omitted). Because § 10(b) is written as a catch-all provision, adjustment of its knowledge requirement in aiding and abetting cases will almost certainly have a tremendous nationwide impact. Any number of business entities may be subjected to potential liability for simply doing their jobs whenever their conduct is later second-guessed by plaintiffs. These entities would not even be able to rely on the state law duties governing their conduct as a guide to their potential liability. The new liability which will result from the court of appeals' permissive aiding and abetting standard cannot be justified given that the court of appeals' rule is inconsistent with *Ernst & Ernst v. Hochfelder*, this Court's leading mandate in this area of the law.

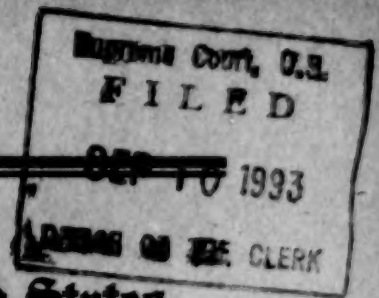
- CONCLUSION -

For the foregoing reasons, the Court should reverse the judgment of the Court of Appeals and reinstate the district court's ruling of summary judgment in favor of Central Bank.

Respectfully submitted this 30th day of July, 1993.

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No. 92-854



IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1993

CENTRAL BANK OF DENVER, N.A.,  
*Petitioner,*  
v.

FIRST INTERSTATE BANK OF DENVER, N.A. and  
JACK K. NABER,  
*Respondents.*

On Writ of Certiorari to the  
United States Court of Appeals  
for the Tenth Circuit

**BRIEF FOR RESPONDENTS**

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September 10, 1993

### **QUESTIONS PRESENTED**

1. Whether there is an implied private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.
2. Does recklessness satisfy the scienter requirement for aiding and abetting even where there is no breach of a duty to disclose or to act?



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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1993

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No. 92-854

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CENTRAL BANK OF DENVER, N.A.,  
*Petitioner,*  
v.  
FIRST-INTERSTATE BANK OF DENVER, N.A. and  
JACK K. NABER,  
*Respondents.*

On Writ of Certiorari to the  
United States Court of Appeals  
for the Tenth Circuit

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**BRIEF FOR RESPONDENTS**

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**STATEMENT OF THE CASE**

Central Bank of Denver was Indenture Trustee for an \$11 million bond issue known as the "Colorado Springs-Stetson Hills Public Building Authority Landowner Assessment Lien Bonds, Series 1988A" (the "1988 bonds"). First Interstate Bank of Denver, N.A. purchased \$2,100,000 of the 1988 bonds, and resold some of them to its customers.<sup>1</sup> Joint Appendix ("J.A."), at 7. Respondents' Amended Complaint alleged that the 1988 bonds were marketed as part of a fraudulent scheme perpetrated by the developer of Stetson Hills, the crux of

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<sup>1</sup> Respondent Jack Naber, a customer of First Interstate, was initially proposed to the federal district court as a class action representative. When the court declined to certify a class, Mr. Naber continued in the case as an individual plaintiff.



which was to induce sales based on fraudulent assurances that the land pledged under an "assessment lien" as collateral for the bonds would continuously be worth 160% of the amount of the bonds, when in fact the collateral was deficient and the purportedly conservative appraisal of it was grossly inflated.<sup>2</sup>

Central Bank provided critical assistance to the fraudulent scheme by taking affirmative steps to ensure that the shortage of collateral and the defects of the appraisal would be hidden from plaintiffs and other potential purchasers, at least until well after the bonds had been sold to the public. J.A. 23-24. First Interstate's Amended Complaint alleged that Central took these steps knowingly or recklessly, and thereby aided and abetted the developer's fraud in violation of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1988 & Supp. III 1991), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1992). J.A. 24-26. As with other participants in the bond issue, Central Bank stood to profit from the offering. Central had already received fees for acting as trustee for the initial \$24 million Stetson bond issue in 1986 (the "1986 bonds"), and in early 1988 was actively preparing to fulfill the same role for the 1988 issue. I R, Tab 12 at 6.

The inflated appraisal of the land pledged to the 1988 bonds was prepared by Joseph Hastings (the same appraiser who had two years earlier evaluated the collateral for the 1986 bonds, and who had also been accepted by Central for the 1988 issue). J.A. 52-53, 73. The combined appraisal document presented to Central Bank in

<sup>2</sup> Under the bond covenants, the "160% test" was to have been based on a "bulk sale," liquidation value appraisal. In the trial court, First Interstate retained an experienced MAI appraiser who evaluated the collateral for the 1988 bonds, using valid comparables and the methodology actually required by the bond covenants. The results showed that the appraisal which accompanied the 1988 issue was inflated by approximately 400 percent. Record on Appeal, Volume I ("I R"), Tab 5 at 2.

early 1988 covered both the 250 acres of Stetson Hills property securing the 1986 bonds, and the separate 272-acre parcel proposed to be pledged as security for the 1988 issue. J.A. 60-61. Central asked Hastings simply to separate this document into its 1986 and 1988 components, which he did. J.A. 61. His methodology in evaluating the collateral was the same, however, for all of the properties. J.A. 68.

Central Bank understood that the purpose of the appraisal was "to provide satisfactory evidence to the Trustee that the 160% test is being met." J.A. 76. When Hastings' methodology came under criticism, including from Central's own expert, a controversy arose which threatened to terminate the 1988 bond issue.

Cheryl Crandall, a Central Bank Corporate Trust Department officer, had been assigned responsibility for Central's duties related to the Stetson bonds. When she reviewed the appraisal early in 1988, she noticed that the values Hastings was then using were purportedly unchanged from the figures he had determined two years earlier. Crandall expected, she recalled, to "see some difference." J.A. 63. Such a difference would have been anticipated given declining property values in El Paso County. J.A. 63-64.

Central Bank also was aware of facts suggesting that bond investors might actually need to resort to the property pledged as security for the 1986 and 1988 bonds: in December 1987 Central had already been forced to draw from a bond reserve fund to make a year-end payment of \$654,000 of principal and interest to the 1986 bondholders. J.A. 62-63; Crandall and Central knew that the lots in the Stetson development were not selling well enough to produce sufficient revenue to replenish the reserve fund. *Id.*

In late January, Crandall received a letter from Dain Bosworth, the investment banking firm which had served as lead underwriter for the 1986 bonds. Dain had not yet

seen Hastings' 1988 appraisal, but had serious misgivings about the adequacy of the bond collateral and believed the developer was violating the bond covenants:

At this date we are operating on an appraisal that is over 16 months old. In light of the declining property values in Colorado Springs and the foreclosure sales, many of which have occurred within the vicinity of the collateral, *an appraisal that reflects property values similar to those utilized for the 1986 appraisal of record should be suspect* and not relied on without further independent check. As Trustee, you have the authority to name an independent appraisal [sic] if you are not satisfied.

It appears that the officers of the Stetson Hills Building Authority have failed to conform to the Bond Covenants to which they agreed. *In the interest of the bondholders I call upon you to enforce the covenants or Invoke the Remedies . . . .*

J.A. 86 (emphasis added). In the letter, in addition to pointing out that the critical 160% test was "probably not being met" as to the 1986 bonds, Dain Bosworth specifically warned Central Bank of fraud by the developer: "The fact that property was released from the Lien of the Indenture without the appropriate amounts being placed in the Bond Fund would suggest that *you may have been given false or misleading certifications.*" J.A. 85-86 (emphasis supplied).

Crandall then independently calculated the 160% test on the collateral for the 1986 bonds. Her work confirmed that, as Dain Bosworth had feared, the value had already fallen below the 160% test, to 131%. J.A. 66.

By that time, Dain had received a copy of Hastings' appraisal of the 1988 bond collateral. On February 22, 1988, Dain sent another letter to Central Bank, this time pointedly criticizing the 1988 appraisal:

Cannot believe that appraiser could not find comparable sales more recent than 1985 and 1986 when

there were several foreclosure sales in 1987. *Using comparables that are tied to a more upbeat market tends to overstate the current value of the . . . collateral.* Even using the 1985 and 1986 comparables, it is hard to see how Hastings could have arrived at a \$5 per square foot current value . . . .

J.A. 108 (emphasis added).

Central Bank had its own appraiser, Ed Elmer, whom it considered to be its "resident expert." J.A. 116. Central referred the Hastings evaluation to Elmer for his review. Elmer also spoke directly with Hastings.<sup>3</sup>

Elmer's review, and his conversation with Hastings, confirmed that the appraisal was inflated and unreliable and that, by Hastings' own admission, it did not conform to the liquidation value methodology required by the bond covenants. In a March 22, 1988 letter to the developer, Crandall summarized Elmer's conclusions and demanded that an independent review of the appraisal be done, and not by Mr. Hastings:

Based upon our review, and the recommendation given us by Mr. Elmer, we will require, in our capacity as Trustee, that an independent review of the appraisal be conducted by a different appraiser . . . .

We are requiring that an independent review of the appraisal be conducted for the following reasons:

1. The age of the comparable sales data makes it *of questionable use as a valid basis for valuation.* We question why more recent sales were not utilized for this purpose.

2. Mr. Hastings has confirmed that his discounting methods did not consider a bulk sale in a forced

<sup>3</sup> This was the only situation in which Central Bank had asked Mr. Elmer to review an appraisal of collateral for a bond issue. J.A. 210. Based on all of the facts, the Tenth Circuit concluded that, "the evidence supports the inference that this was not an ordinary transaction." *Id.*



liquidation context, as is specifically required by the Indenture.

3. Based on our review and investigation, the *values determined by the appraisal appear to be unjustifiably optimistic*, given the current economic conditions in the residential and commercial real estate markets in El Paso County.

J.A. 117 (emphasis added).

Within only a matter of days, however, after Crandall sent this letter, the head of Central Bank's Trust Department, Kenneth Buckius, took charge from Crandall of Central's duties related to the Stetson bonds. J.A. 69. On March 31, 1988, Buckius met with representatives of the developer and of the lead underwriter. The developer's representative, Greg Timm, proposed simply to go forward with the sale of the bonds, to use the inflated appraisal, and to put off an independent review until six months after the closing. Appraiser Hastings would be asked to sign off on a "certification letter." Central Bank's notes of the meeting reflect that Hastings would not be drafting the letter himself: "draft letter to see if Hastings can live with it." J.A. 119. The developer would contribute additional land to the collateral, but only for the 1986 issue, *not the 1988 bonds*. J.A. 45-50. The non-conforming methodology of Hastings' 1988 appraisal, resulting in what Central's expert termed "unjustifiably optimistic" values, remained uncorrected. J.A. 116-117, 122-123.

On May 13, 1988, Central Bank, by Kenneth Buckius, entered into a side agreement with the Stetson developer, permitting the 1988 bonds to be marketed under the Hastings appraisal, with the independent review to be postponed until December 1988, six months after the bonds were to be sold to the public. J.A. 124-125. Central Bank's essential role in the decision was noted: "Need to get Ken [Buckius of Central Bank] to go to [Central Bank] Trust Committee to buy off on Greg's offer." J.A. 118.

The Certification earlier drafted for Hastings was not executed by him until June 16, 1988, more than one month after Central Bank had already agreed with the developer to delay an independent review. J.A. 154. The Certification, which Central says it relied upon to satisfy its concerns about the appraisal, does not represent that the methodology required by the Indenture was used, but rather that the result was the same. J.A. 153, ¶ 5.

By the end of 1988, the risks to bond purchasers earlier flagged by Central's appraiser Ed Elmer had materialized. In April 1989, the holders of \$26 million of Stetson Hills 1986 and 1988 bonds received letters from Central Bank (J.A. 20) disclosing, for the first time, that in December 1988 the developer had failed to supply the promised year-end appraisal of the 1988 bond collateral. That document was never forthcoming. By the summer of 1990, the reserve fund was depleted, and the 1988 bonds lapsed into monetary default. J.A. 20-21. It was then revealed to bondholders that the collateral had, after all, not been worth 160% of the bonds, but substantially less than even the bond principal.

In the trial court and in the Tenth Circuit, respondents showed that the evidence of Central Bank's extensive involvement in the issuance of the 1988 bonds, its receipt of credible warnings of fraud by the developer, its awareness of the magnitude of the risks to bond purchasers posed by an inflated appraisal, and its participation in a concealed side agreement with the developer to forego timely review of that appraisal, all gave rise at least to an inference of recklessness, if not of actual knowledge by Central Bank of the fraudulent scheme charged in the Amended Complaint.

In its opinion, the Tenth Circuit said that "Central Bank has mischaracterized plaintiffs' claim as one alleging that Central Bank improperly did not disclose certain facts . . . . But plaintiffs' claim against Central Bank is different. Plaintiffs allege that Central Bank assisted



the primary violation by *affirmative action*, specifically by affirmatively agreeing to delay the independent review of the Hastings appraisal." J.A. 207 (emphasis in original).<sup>4</sup> Reviewing in detail the factual background, the Tenth Circuit concluded that, "the bank's knowledge of the alleged inadequacies of the Hastings updated appraisal could support a finding of extreme departure from the standards of ordinary care," that plaintiffs had "established a genuine issue of material fact as to the scienter element of aiding-and-abetting liability," and that summary judgment in favor of Central Bank was not appropriate. J.A. 212-213.

### SUMMARY OF ARGUMENT

On this appeal, petitioner seeks to overturn the Tenth Circuit's opinion and judgment on the grounds that: (1) as an aider and abettor, petitioner could not be subject to the private action under § 10(b) of the 1934 Act and SEC Rule 10b-5 promulgated thereunder; and (2) if aiders and abettors are liable under § 10(b), petitioner should not be liable for recklessness, even if it actively and substantially assisted a fraudulent scheme, unless it had owed a preexisting duty to the victims of the fraud. Respondents disagree.

Secondary liability for aiding and abetting would have been provided for had Congress included an express private remedy under § 10(b). With the collapse of this country's financial markets in 1929, Congress enacted the Securities Act of 1933 and the Securities and Exchange Act of 1934 in large part as a determined response to perceived shortcomings of the common law of deceit. Congress would not have excluded from the "catchall" anti-fraud provision of the 1934 act an aiding and abetting remedy already recognized by the common law. Civil liability for aiding and abetting is consistent with

<sup>4</sup> The decision below is *First Interstate Bank of Denver, N.A. v. Pring*, 969 F.2d 891 (10th Cir. 1992), *cert. granted*, 113 S. Ct. 2927 (1993). J.A. 183-213.

the language of § 10(b), and with the purpose and structure of the federal securities laws.

Over the past three decades, hundreds of federal court opinions have unanimously upheld and applied civil aiding and abetting as a vital, integral component of the 10b-5 remedy. Subsequent Congresses have endorsed this judicial interpretation and have effectively ratified the private aiding and abetting action. These affirmations reinforce the conclusions from the language and history of the securities Acts. Without unacceptable damage to congressional intent and to the jurisprudence of § 10(b), secondary liability may not be severed away from the 10b-5 action as a whole.

The 1934 Congress intended that "scienter," the requisite state of mind for both primary violations and aiding and abetting, would encompass reckless conduct. In addition to being fully congruent with the congressional purpose inferable from the statutory language and policy, the recklessness standard is supported by a consistent history of application in the common law. The common law of deceit, which Congress invoked in § 10(b)'s proscription against "deceitful" conduct, made recklessness actionable both for primary fraud and for aiding and abetting. A recklessness standard under the aiding and abetting remedy serves the congressional purpose to move decisively forward, not backward, from the common law, and is supported by the fact that each of the express remedies in the 1933 and 1934 Acts also reaches reckless behavior.

The necessary state of mind for the knowledge or scienter element of the aiding and abetting remedy should remain constant, without regard to the defendant's fiduciary duties. The 1934 Congress nowhere provided for a shifting scienter requirement based on fiduciary duty, either in the language of § 10(b) or elsewhere in the federal securities laws. Petitioner's proposed "duty/no duty" test bears no rational relation to the evidence of congressional intent.

Moreover, that proposed test ignores the principle that, totally apart from duties to act or to disclose, a party is responsible for the consequences when it actively assists wrongdoing. Central Bank was not an unwitting outsider which suddenly found itself innocently at the margins of a securities violation. When Central moved recklessly to thwart review of an appraisal whose serious risks to investors it had earlier identified and confirmed, it was a culpable actor, not a bystander. Having chose to act, Central Bank's 10b-5 liability and its requisite state of mind could no longer depend upon arguments over whether initially it may or may not have had a duty to Act.

#### ARGUMENT

##### **I. LIABILITY FOR AIDING AND ABETTING SECURITIES FRAUD FALLS SQUARELY WITHIN THE CONTOURS OF THE § 10(b) PRIVATE ACTION AS FRAMED BY CONGRESSIONAL INTENT AND BY THIS COURT'S DEVELOPED § 10(b) JURISPRUDENCE**

It is not surprising that after three decades of its delineation and acceptance in the lower federal courts, aiding and abetting liability was neither challenged by Central Bank nor raised by the Tenth Circuit in this case. Respondents agree with the Tenth Circuit and with the other lower federal courts that the aiding and abetting remedy is an integral, and vital, element of the 10b-5 private action.

##### **A. The Private § 10(b) Remedy Must Conform To The Contours Which Would Have Been Shaped By The 1934 Congress; Aiding And Abetting, Like Contribution, Is An Appropriate And Essential Increment Of The § 10(b) Action**

The variously elaborated theme of petitioner is that the 1934 Congress never intended civil aiding and abetting under § 10(b), because Congress did not explicitly create a private remedy. It is too late, however, to purport to analyze the issues in the present case from an assumption

that the 1934 Congress was antithetical to the private right of action recognized by this Court.<sup>5</sup>

The working presumption that the 1934 Congress intended the private remedy is followed by the corollary that Congress would have crafted § 10(b) liability as a whole, providing at least for such integral elements as a statute of limitations, a right to contribution and, here, secondary liability. *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 113 S. Ct. at 2089-90 (1993) (contribution); *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773 at 2778 (statute of limitations). Given this presumption, the "task is . . . to attempt to infer how the 1934 Congress would have addressed the issue had the 10b-5 action been included as an express provision in the 1934 Act." *Musick*, 113 S. Ct. at 2089-90; *Lampf*, 111 S. Ct. at 2780.

For the most part, petitioner eschews this test, and contends instead that aiding and abetting should be analyzed under the Court's post-1975 test for previously unrecognized implied actions. *Cort v. Ash*, 422 U.S. 66 (1975). This approach, however, would improperly disassemble § 10(b), applying the pre-1975 test to components addressed by the Court before 1975 and applying the post-1975 test to the parts addressed thereafter. Such a method could only lead to a hodgepodge of inconsistent rules of law, unnecessarily complicating the already complex jurisprudence of § 10(b) and Rule 10b-5. *Musick* provides the correct approach, analyzing whether aiding and abetting as an increment of § 10(b) liability is con-

<sup>5</sup> As early as 1971, in the first case to come before the Court under the Rule, the Court was satisfied with Justice Douglas's simple statement: "It is now established that a private right of action is implied under § 10(b)," *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971). In 1983, the Court referred to the private civil action as "simply beyond peradventure." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983).



sistent with the probable design of the private action by the 1934 Congress. Given, as the Court held in *Musick*, that Congress would have afforded, to the perpetrators of a fraudulent scheme, legal recourse against others who may have "contributed" to five percent or ten percent of the wrongdoing, would not Congress also have made available to the victims of that scheme legal recourse against those who actively assisted the fraud? Respondents believe that the answer provided by the language and history of § 10(b) is squarely in the affirmative.

**B. The 1934 Congress Would Have Intended The 10b-5 Action To Include An Aiding And Abetting Remedy**

The congressional design for the 10b-5 remedy must be inferred from the language, history, statutory structure, and legislative purposes of § 10(b), and from analogous provisions of the 1933 and 1934 Acts. *Musick*, 113 S. Ct. at 2089-91. All of these sources support the private action for aiding and abetting.

In 1934, Congress confronted what would become a decade-long national economic depression, in large part induced by the ruin of the Republic's financial markets. Congress had begun the process of enacting comprehensive securities legislation to restore public confidence in the market, by mandating full disclosure and by taking other steps to bring under control rampant securities fraud and manipulation. See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963).<sup>6</sup> One such

<sup>6</sup> In *Capital Gains*, Justice Goldberg wrote:

The Investment Advisors Act of 1940 was the last in a series of Acts designed to eliminate certain abuses in the securities industry, abuses which were found to have contributed to the stock market crash of 1929 and the depression of the 1930's. It was preceded by the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, and the Investment Company Act of 1940. A fundamental purpose, common to these

step was the enactment of the prohibitions of § 10(b), which, through existing statutes, made aiding and abetting a crime. Presuming that Congress had provided a civil remedy, Congress would have intended that civil remedy to reach aiding and abetting as well.

**1. Congress Intended § 10(b) to Extend to a Wide Range of Culpable Conduct by a Broad Class of Defendants**

Petitioner maintains that because the words "aiding and abetting" do not appear in the text of § 10(b), Congress did not intend that statute to extend to those who culpably assist the carrying out of a fraudulent scheme. When § 10(b) was enacted, criminal liability for aiding and abetting offenses against the United States was already provided in the general criminal aiding and abetting statute. See Act of March 4, 1909, ch. 321, § 332, 35 Stat. 1152 (formerly 18 U.S.C. § 550).<sup>7</sup> These federal offenses included violation of the criminal section of the 1934 Act, which in turn applied to the other provisions of the Act, including § 10(b) and Rule 10b-5. Securities Exchange Act § 32, 15 U.S.C. § 78ff (1988). No one disputes that the prohibitions of § 10(b) have given rise to criminal aiding and abetting since the promulgation of Rule 10b-5 in 1942. See, e.g., *United States v. Gleason*, 616 F.2d 2 (2d Cir. 1979), *cert. denied*, 444

statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry. As we recently said in a related context, "It requires but little appreciation . . . of what happened in this country during the 1920's and 1930's to realize how essential it is that the highest ethical standards prevail" in every facet of the securities industry.

*Ibid.* (quoting *Silver v. New York Stock Exch.*, 373 U.S. 341 (1963)) (footnotes omitted).

<sup>7</sup> Today, the statute broadly provides that "[w]hoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission is punishable as a principal." 18 U.S.C. § 2(a) (1988).



U.S. 1082 (1980). It would be anomalous to infer that Congress, having made aiding and abetting securities fraud a crime, would have immunized aiders and abettors from civil liability under the private action.

To the contrary, the language of § 10(b) manifests a congressional purpose to reach an expansive category of wrongdoers and of wrongdoing. Specifically, § 10(b) provides comprehensively that:

It shall be unlawful for *any person*, directly or *indirectly* by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j (1988 & Supp. III 1991) (emphasis added).<sup>8</sup>

<sup>8</sup> Pursuant to § 10(b), in 1942 the Commission enacted Rule 10b-5, which provides:

It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

[Continued]

The phrase “unlawful for any person,” underscores that § 10(b) does apply, and was intended to apply, to a broad class of defendants. Inclusion of those who act “indirectly” suggests a legislative purpose fully consistent with the prohibition of aiding and abetting. See, Elizabeth Sager, Note, *The Recognition of Aiding and Abetting in the Federal Securities Laws*, 23 Hous. L. Rev. 821, 846 (1986) (aiding and abetting is consistent with liability for “those who only ‘indirectly’ employ ‘manipulative or deceptive’ practices”). The language of § 10(b) supports a congressional intention to remedy and to deter not just primary wrongdoing but complicity as well.<sup>9</sup>

**2. Congress’ Undoubted Purpose To Fortify Existing Protections Against Securities Fraud Requires the Existence of Civil Aiding and Abetting Under § 10(b), Just to Keep Pace with the Common Law of Deceit**

Unlike the right of contribution recognized by the Court in *Musick*, civil aiding and abetting was already well-established when Congress enacted § 10(b) and had been frequently applied to common law fraud and deceit.<sup>10</sup>

<sup>8</sup> [Continued]

17 C.F.R. § 240.10b-5 (1992). Nothing in the language of the Rule suggests that the Commission intended to preclude or restrict aiding and abetting liability. Indeed, the Commission has long enforced Rule 10b-5 against aiders and abettors, both in administrative actions and in civil injunctive proceedings. See, e.g., *Batten & Co. v. SEC*, 345 F.2d 82 (D.C. Cir. 1964); *SEC v. Spectrum, Ltd.*, 489 F.2d 535 (2d Cir. 1973).

<sup>9</sup> The private action for aiding and abetting is also consistent with the congressional intent reflected by the words “manipulative” and “deceptive” in § 10(b). As a form of secondary liability, aiding and abetting includes the prohibited “manipulative” or “deceptive” conduct through the underlying primary violation. Aiding and abetting is an “indirect” method of effecting a “manipulative or deceptive device or contrivance.”

<sup>10</sup> While aiding and abetting also may have criminal law antecedents, the tort law background of the elements of the aiding-

See, e.g., *Virtue v. Creamery Package Mfg. Co.*, 123 Minn. 17, 40, 142 N.W. 930, 939 (1913) (following "well-recognized" rule that all who actively participate in a tort, or who "aid, or abet its commission," are "jointly and severally liable therefor"); *White v. Moran*, 134 Ill. App. 480, 491-92 (1907) (finding persons *in pari delicto* with primary violator if they had actual "or constructive knowledge" of fraudulent character of enterprise and "aided and abetted in its furtherance."<sup>11</sup>)

abetting doctrine extends back at least to the mid-1800's, see, e.g. *Prince v. Flynn*, 12 Ky. 240, 243-44 (1822); *Clark v. Bales*, 15 Ark. 452, 458 (1849); *Northern Trust Co. v. Palmer*, 171 Ill. 383, 49 N.E. 553, 555 (1898), and supplies a more logical resource from which to determine the intent of the 1934 Congress regarding the contours of the private § 10(b) action. See Brief for Petitioner at 28; William H. Kuehnle, *Secondary Liability Under the Federal Securities Laws—Aiding and Abetting, Conspiracy, Controlling Person, and Agency: Common-Law Principles and the Statutory Scheme*, 14 J. CORP. L. 313, 328 (1988). The punitive purposes of the criminal law diverge materially from the primary goal of the civil aiding and abetting doctrine of apportion responsibility for harm. Kuehnle, *supra*, at 322-23.

<sup>11</sup> See also *Cross v. Sylvia Silk Co.*, 222 App. Div. 134, 136, 225 N.Y.S. 552, 554 (N.Y. App. Div. 1927) (civil aiding and abetting based on fraud); *McClung v. Watt*, 190 Cal. 155, 161, 211 P. 17, 20 (1922) (same); *Fink v. Weisman*, 129 Cal. App. 305, 18 P.2d 961, 965 (1993); *Duguid v. Coldsnow*, 76 Ind. App. 545, 549-50, 132 N.E. 659, 660 (1921) (same); *Raasch v. Lund Land Co.*, 103 Neb. 157, 162, 170 N.W. 836, 838 (1919) (same); *Ft. Myers Dev. Corp. v. J.W. McWilliams Co.*, 122 So. 264, 268 (Fla. 1929) (same); *Svalina v. Saravana*, 341 Ill. 236, 248, 173 N.E. 281, 286 (1930) (same); *Barker v. Fordville Land Co.*, 264 Mich. 95, 249 N.W. 491, 492 (1933) (same); *Leimkuehler v. Wessendorf*, 323 Mo. 64, 97-98, 18 S.W.2d 445, 453 (1929) (same); *Fountain Spring Park Co. v. Roberts*, 92 Wis. 345, 348, 66 N.W. 399, 400 (1896) (same); 1 THOMAS M. COOLEY, A TREATISE ON THE LAW OF TORTS OR THE WRONGS WHICH ARISE INDEPENDENTLY OF CONTRACT § 85, at 273 (4th ed. 1932) ("All who actively participate in any manner in the commission of a tort, or who command, direct, advise, encourage, aid or abet its commission are jointly and severally liable therefore."); RESTATEMENT OF TORTS § 876(b) (1939).

Because the 1934 Congress is presumed to have been aware of developments in the common law which it intended to buttress, see *Capital Gains*, 375 U.S. at 195, it would neither have scaled back nor, even less likely, excluded aiding and abetting (and other existing forms of secondary liability) from the general anti-fraud provision of the 1934 legislation. See *Herman & MacLean v. Huddleston*, 459 U.S. 390, 388-89 (1983) (important purpose of the federal securities statutes was to "rectify perceived deficiencies" of common-law protections by establishing "higher standards of conduct in the securities industry."); *Basic Inc. v. Levinson*, 485 U.S. 224, 244 n.22 (1988) (10b-5 actions in part designed to "add to the protections provided investors by the common law."); *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310-11 (1985) (altering common-law *in pari delicto* doctrine to broaden class of plaintiffs entitled to § 10(b) recovery); cf. *Franklin v. Gwinnett County Public Schools*, 112 S. Ct. 1028, 1035-36 (1992) (presuming that legislature intended implied remedies under Title IX of Education Amendments of 1972 to be at least as expansive as the then current state of the common law).

### 3. Analogous Provisions of the 1934 Act also Are Consistent with a Private Remedy for Aiding and Abetting

Express private remedies found elsewhere in the 1934 Act, are additional sources from which to infer how Congress would have defined the 10b-5 remedy. *Musick*, 113 S. Ct. at 2090-91; *Lampf*, 111 S. Ct. at 2780-81. The Court has twice held that §§ 9 and 18 of the 1934 Act are the closest to § 10(b) in purpose and effect, and thus the most instructive. *Musick*, 113 S. Ct. at 2090-91; *Lampf*, 111 S. Ct. at 2780-81.

The design of §§ 9 and 18 support the 10b-5 private remedy. As with § 10(b), violations of §§ 9(a)-(c) give rise to criminal liability for aiding and abetting through the criminal aiding and abetting statute. See, e.g., *United States v. Shindler*, 13 F.R.D. 292, 294 (S.D.N.Y. 1952).



The SEC has also brought aiding and abetting actions under § 9. *See SEC v. Militano*, 773 F. Supp. 589, 594-95 (S.D.N.Y. 1991) (applying aiding and abetting in SEC civil action under § 9(a)(2)); *In re Barry L. Lefko*, Exchange Act Release No. 17181, 21 S.E.C. 19, 21 (Sept. 30, 1980) (applying aiding and abetting in SEC administrative action under § 9(a)(2)).—The private remedy arises under subsection 9(e), which specifically provides for the civil liability of “any person who willfully participates” in any act or transaction in violation of §§ 9(a)-(c). 15 U.S.C. § 78i(e) (1988 & Supp. III 1991); *see Walck v. American Stock Exch.*, 565 F. Supp. 1051, 1064 (E.D. Pa. 1981) (applying aiding and abetting in private action under § 9(e), but finding insufficient factual basis), *aff’d*, 687 F.2d 778 (3d Cir. 1982), *cert. denied*, 461 U.S. 942 (1983).

Section 18, while not containing an explicit aiding and abetting provision, also by its terms extends past primary wrongdoing, to reach the civil liability of those who knowingly make or “cause to be made” misleading statements. *See In re Equity Funding Corp. of Am. Sec. Litig.*, 416 F. Supp. 161, 179-81 (C.D. Cal. 1976) (applying aiding and abetting in private action under § 18); *In re Investors Funding Corp. of New York Sec. Litig.*, 523 F. Supp. 533, 542 (S.D.N.Y. 1980) (same); *In re Caesars Palace Sec. Litig.*, 360 F. Supp. 366, 386 (S.D.N.Y. 1973) (same).

Even without including specific “aiding and abetting” language, it is likely that the 1934 Congress presumed that such liability would apply under the express private remedies. *Cf. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 394 (1982) (holding that the secondary liability of conspirators “necessarily follows” from the finding of an implied right of action under the Commodity Exchange Act). Indeed, before enactment of the federal criminal statute in 1909, even federal criminal aiding and abetting, with all of its potentially grave individual consequences, had already been implied by the

common law. *See United States v. Martin*, 176 F. 110, 113-14 (N.D. Iowa 1910).

Petitioner maintains that the 1934 Congress may be seen to have excluded other forms of secondary liability, such as aiding and abetting, simply because it enacted “controlling person” liability under § 20 of the 1934 Act (which applies directly to civil liability under § 10(b)) and under § 15 of the 1933 Act. 15 U.S.C. §§ 77o & 78t (1988). The legislative history refutes this speculation. Congress enacted § 15 of the 1933 Act and § 20 of the 1934 Act to provide a novel mechanism of secondary liability, not present in the common law and especially suited to the securities marketplace, where parties who would otherwise be culpable might escape accountability by operating from behind the scenes.<sup>12</sup> There is no persuasive basis to extrapolate from these provisions a sup-

<sup>12</sup> Nothing in the legislative history of these sections suggests that Congress ever intended them to be preemptive of all, or any, other forms of secondary liability. The “controlling person” legislation aimed specifically to prevent the use of “dummies” to avoid personal responsibility. *See* Nancy C. Staudt, Note, “Controlling” Securities Fraud: Proposed Liability Standards for Controlling Persons Under the 1933 and 1934 Securities Acts, 72 MINN. L. REV. 930, 934-39 (1988) (describing legislative history of § 15 of the 1933 Act and § 20 of the 1934 Act). The proposed legislation, defined a “dummy” as “a person who holds legal or nominal title to any property but is under moral or legal obligation to recognize another as the owner thereof.” S. 875, 73d Cong., 1st Sess., 77 CONG. REC. 2979 (May 8, 1933), *reprinted in* 1 J. ELLENBERGER & E. MAHAR, LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934, Item 8 (1973) [hereinafter LEGISLATIVE HISTORY]; *see also Federal Securities Acts: Hearings on H.R. 4314 Before the House Interstate and Foreign Commerce Committee*, 73d Cong., 1st Sess. 122 (1933) (statement of Rep. Parker) (concerned that persons controlling a corporation committing securities fraud might seek to evade liability by appointing directors without actual authority to direct or manage corporate affairs), *reprinted in* 2 LEGISLATIVE HISTORY, *supra*, Item 20.



posed congressional intent to erase other forms of common law secondary liability.<sup>13</sup>

Petitioner also maintains that no right of action for aiding and abetting need be recognized because Congress "decided" not to enact amendments proposed in 1957, 1959 and 1960 that would, among other things, have included within § 20 an express aiding and abetting remedy for SEC injunctive actions. Brief, pp. 20-22. However, as this Court has stated, or perhaps understated, "unsuccessful attempts at legislation are not the best guides to legislative intent." *Red Lion Broadcasting Co. v. FCC*,

<sup>13</sup> The First, Second, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth and Tenth Circuits have held that controlling person liability is intended to supplement, not to supplant existing forms of secondary liability. See, e.g., *In re Atlantic Fin. Management, Inc. Sec. Litig.*, 784 F.2d 29, 33 (1st Cir. 1986), cert. denied sub nom, *AZL Resources, Inc. v. Margaret Hal Foundation*, 481 U.S. 1072 (1987); *SEC v. Management Dynamics, Inc.*, 515 F.2d 801, 812 (2d Cir. 1975); *Johns Hopkins Univ. v. Hutton*, 297 F. Supp. 1165, 1211-12 (D. Md. 1968), aff'd in part, rev'd in part, 422 F.2d 1124, 1130 (4th Cir. 1970); *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118-19 (5th Cir. 1980); *Holloway v. Howerdd*, 536 F.2d 690, 694-95 (6th Cir. 1976); *Fey v. Walston & Co.*, 493 F.2d 1036, 1051-52 (7th Cir. 1974); *Commerford v. Olson*, 794 F.2d 1319, 1323 (8th Cir. 1986); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1576-77 (9th Cir. 1990), cert. denied, 111 S. Ct. 1621 (1991); *Kerbs v. Fall River Indus.*, 502 F.2d 731, 740-41 (10th Cir. 1974); see also John Musewicz, *Vicarious Employer Liability and Section 10(b): In Defense of the Common Law*, 50 GEO. WASH. L. REV. 754, 789-90 (1982) (1934 Act's scheme and legislative history "strongly supports a conclusion that section 20(a) was meant to supplement rather than replace common-law employer liability"); William Seiter, Comment, *Rule 10b-5 and Vicarious Liability Based on Respondeat Superior*, 69 CAL. L. REV. 1513, 1527 (1981) legislative history does not indicate a congressional intent to preclude the imposition of employer liability without fault). The Third Circuit similarly agrees in general terms since it recognizes aiding and abetting under § 10(b); however, it holds that § 20's "good faith" defense applies even where § 20 overlaps other forms of secondary liability based on lesser culpable states of mind. See, e.g., *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, 884-85 (3d Cir. 1975).

395 U.S. 367, 381-82, n.11 (1969). The principle surely applies here, since Congress was neither addressing, nor was it asked to address, the private action for aiding and abetting; nor did Congress express any intent to restrict the 10b-5 remedy.<sup>14</sup>

In contrast to the remote and ambiguous legislative history on which petitioner relies, other Congresses have directly and specifically expressed their approval of the aiding and abetting action. For example, prior to enacting the Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, the 1983 Congress "endors[ed] the judicial application of the concept of aiding and abetting liability to achieve the remedial purposes of the securities laws." H.R. REP. NO. 355, 98th Cong., 2d Sess. 10 & n.17 (1983). That this endorsement comprehended the private 10b-5 action is confirmed by a direct citation, in the House Report, to the Second Circuit's decision applying the 10b-5 remedy in *Rolf v Blyth, Eastman Dillon*

<sup>14</sup> The legislative history reflects that "the purpose of the unadopted aider and abettor amendments was 'to strengthen and clarify the injunctive power' rather than to add a new element to the power of the SEC." *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673, 677-80 (N.D. Ind. 1966) (quoting S. REP. NO. 1757, 86th Cong., 2d Sess. 8 (1960)), aff'd, 417 F.2d 147 (7th Cir. 1969); see also *Hearings on S. 1178-1182 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 86th Cong., 1st Sess., at 276, 335 & 54 (1959) (amendment merely intended to clarify SEC's injunctive power against aiders and abettors). Ultimately, Congress may not have enacted these provisions because of a view that they were an unnecessary codification of existing law, or simply because the 86th Congress ran out of time. See *Brennan*, 259 F. Supp. at 680 ("[p]erhaps Congress did not act on the reported bills" because "the committee considered such codification unnecessary"); LOSS, SECURITIES REGULATION, 205-260 n.80 (2d ed. 1961) ("Recognizing the short time remaining in the 86th Congress to insure legislation by both bodies, the committee was forced to postpone consideration of controversial amendments originally proposed by the Commission.") (quoting 106 CONG. REC. 14,500 (daily ed. July 2, 1960)).

[Continued]

& Co., 570 F.2d 38 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978). *Ibid.*

In summary, the efforts of the 1934 Congress to strengthen and vitalize common-law fraud doctrines (which had already accommodated a civil remedy for aiding and abetting), the context of existing criminal aiding and abetting liability under the statute, the language of § 10(b), and the expansive remedies, together point directly to the conclusion that the 1934 Congress would have affirmed, rather than precluded, the accountability of parties who aid and abet violations of the 1934 Act and Rule 10b-5.

**C. When It Comprehensively Amended The Federal Securities Laws In 1975, Congress Left § 10(b) Intact And Thus Ratified The Aiding And Abetting Remedy**

In 1975 Congress comprehensively amended the federal securities laws, leaving undisturbed the provisions under which the federal courts had implied the aiding and abetting remedy. In *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983), the Court described the 1975 legis-

<sup>14</sup> [Continued]

Furthermore, eventually Congress *did* enact SEC enforcement provisions against aiding and abetting in 1964, 1975, 1986 and 1990. See Brief for Petitioner at 23. Petitioner argues, in the alternative and without any support from the legislative history, that the failure of *these* Congresses to enact an express private remedy for aiding and abetting somehow demonstrates legislative opposition to the private remedy. The facts are exactly contrary to this hypothesis. When the first of these provisions was enacted in 1964 it was only reasonable for Congress to leave the development of implied private rights to the judiciary. See *Cannon v. University of Chicago*, 441 U.S. 77, 718 (1979) (Rehnquist, J., concurring) ("Cases such as *J.I. Case Co. v. Borak*, *supra*, [which was decided in 1964,] and numerous cases from other federal courts, gave Congress good reason to think that the federal judiciary would undertake this task."). By 1975, the private remedy for aiding and abetting was well-recognized by the judiciary and Congress. See *infra* text pp. 22-26 and notes 17 & 19.

lation as "the 'most substantial and significant revision of this country's federal securities laws since the passage of the Securities Exchange Act in 1934.'" *Id.* at 384-85 (quoting *Securities Acts Amendments of 1975: Hearings on S. 249 before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 1st Sess., 1 (1975)).

At the time of these sweeping amendments, the private aiding and abetting remedy had been judicially identified for at least 13 years, since *Pettit v. American Stock Exchange*, 217 F. Supp. 21, 28 (S.D.N.Y. 1963), and had roots as old as the private § 10(b) action itself.<sup>15</sup> By 1975, a private action for aiding and abetting had been upheld by each of the six federal courts of appeal to have addressed it, namely, the Second, Third, Fifth, Seventh, Ninth and Tenth Circuits. See, e.g., *Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973); *Landy v. FDIC*, 486 F.2d 139 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974); *Herpich v. Wallace*, 430 F.2d 792 (5th Cir. 1970); *Brennan v. Midwestern United Life Ins. Co.*, 417 F.2d 147 (7th Cir. 1969); *Wessel v. Buhler*, 437 F.2d 279 (9th Cir. 1971); *Kerbs v. Fall River Indus.*, 502 F.2d 731 (10th Cir. 1974). Aiding and abetting also had been recognized by district courts in the First, Fourth, Sixth and Eighth Circuits. See, e.g., *Bronner v. Goldman*, 236 F. Supp. 713 (D. Mass. 1964), *aff'd*, 361 F.2d 759 (1st Cir.), *cert. denied*, 385 U.S. 933 (1966); *Sohns v. Dahl*, 392 F. Supp. 120 (W.D. Va. 1975); *Holloway v. Howerdd*, 377 F. Supp. 754, 763 (MD. Tenn. 1973), *aff'd*, 536 F.2d 690 (6th Cir. 1976); *Anderson v. Francis I. Dupont & Co.*, 291 F. Supp. 705, 709 (D. Minn. 1968).<sup>16</sup>

<sup>15</sup> See, *supra* note 11, and, *infra* note 20.

<sup>16</sup> See also *Pettit v. American Stock Exchange*, 217 F. Supp. 21, 28 (S.D.N.Y. 1963); *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673, 680 (N.D. Ind. 1966); *Robbins v. Banner Indus.*, 285 F. Supp. 758, 761 (S.D.N.Y. 1966); *Fischer v. Kletz*, 266 F. Supp. 180, 190 (S.D.N.Y. 1967); *Ross v. Licht*, 263 F. Supp. 395, 410 (S.D.N.Y. 1967); *Brennan v. Midwestern United Life*



Because judicial recognition of civil aiding and abetting under § 10(b) and Rule 10b-5 was both established and unanimous by 1975, Congress' enactment of the 1975 amendments fully justifies the interpretive canon that Congress ratified the judicial interpretation by leaving intact the statute under which it had been invoked. See, e.g., *Herman & MacLean v. Huddleston*, 459 U.S. 375, 385-86 (1983) ("When Congress acted, federal courts had consistently and routinely permitted a plaintiff to proceed under § 10(b) even where express remedies were available. In light of this well-established judicial interpretation, Congress' decision to leave § 10(b) intact suggests that Congress ratified the cumulative nature of the § 10(b) action."); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 381-82 (1982) (comprehensive 1974 amendment of Commodity Exchange Act left intact statutory provisions under which implied cause of action had become part of "contemporary legal context," thus evidencing that "Congress affirmatively intended to preserve that remedy." (citation omitted)); *Lorillard v. Pons*, 434 U.S. 575, 580-81 (1978) (respecting right to jury trial in Age Discrimination in Employment Act, Congress is "presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change." (footnote omitted)); *NLRB v.*

*Ins. Co.*, 286 F. Supp. 702, 728 (N.D. Ind. 1968); *Wasnowic v. Chicago Bd. of Trade*, 352 F. Supp. 1066, 1070 (M.D. Pa. 1972), *aff'd*, 491 F.2d 752 (3d Cir. 1973), *cert. denied*, 416 U.S. 994 (1974); *Robinson v. Penn Central Co.*, 58 F.R.D. 436, 441 (S.D.N.Y. 1973); *Green v. Jonhop, Inc.*, 358 F. Supp. 413, 419 (D. Or. 1973); *In re Caesars Palace Sec. Litig.*, 360 F. Supp. 366, 387 (S.D.N.Y. 1973); *Gold v. DCL Inc.*, 399 F. Supp. 1123 (S.D.N.Y. 1973); *Lewis v. Marine Midland Grace Trust Co.*, 63 F.R.D. 39 (S.D.N.Y. 1973); *Gordon v Burr*, 366 F. Supp. 156, 163-64 (S.D.N.Y. 1973), *aff'd in part, rev'd in part*, 506 F.2d 1080 (2d Cir. 1974); *Ingenito v. Bermec Corp.*, 376 F. Supp. 1154, 1165 (S.D.N.Y. 1974); *Bienewski Ltd. Partnership v. Tising*, 63 F.R.D. 360 (E.D. Wis. 1974); *In re Republic Nat. Life Ins. Co.*, 387 F. Supp. 902, 905-06 (S.D.N.Y. 1975); *Muth v. Dechert, Price & Rhoads*, 391 F. Supp. 935, 938 (E.D. Pa. 1975); *Mitzner v. Cardet Intern., Inc.*, 394 F. Supp. 1119, 1122-23 (N.D. Ill. 1975).

*Guillet Gin Co.*, 340 U.S. 361, 365-66 (1951); George Brunelle, *A "Contemporary Legal Context" Analysis of Aiding and Abetting*, 11 SEC. REG. L.J. 182, 187 (1983) (Under the *Huddleston* test, "a private right of action for aiding and abetting under Rule 10b-5 was either ratified or created by Congress' 1975 toleration of the theory.").

That the 1975 Amendments effected a ratification of the aiding and abetting remedy is just as compelling as the ratification which the Court found in *Huddleston*. There, the Court concluded that Congress had ratified the judicially developed rules allowing § 10(b) liability to "overlap," in part, the express remedy under § 11 of the 1933 Act. 459 U.S. at 384-86. Relying on holdings from the Second, Fifth, Seventh, Ninth and Tenth Circuits and the District of Massachusetts, the Court observed that although this doctrine had had an uncertain start, it was almost uniformly accepted by 1975. *Id.* at 385 n.21. In the present case, aiding and abetting was at least as "uniform and well understood" as the overlap rule recognized in *Huddleston*, and was, with at least equal if not greater force, an important part of the "contemporary legal context" of the § 10(b) action. *Huddleston*, 459 U.S. at 385-86; *Merrill Lynch*, 456 U.S. at 380.

There is also more recent, and specific, congressional approval of the aiding and abetting remedy. When Congress enacted in 1988 the Insider Trading and Securities Fraud Enforcement Act (ITSFEA), Pub. L. No. 10-704, the § 10(b) action provided the most significant enforcement tool against insider trading. See Jeffrey M. Lambert, Note, *Insider Trading: Secondary Liability Under the Federal Securities Law—Lawyers Beware*, 38 DRAKE L. REV. 425, 425 (1988-1989). Congress wanted to ensure that the ITSFEA would not be judicially construed to "freeze out" implied remedies<sup>17</sup> or to "affect the avail-

<sup>17</sup> The Committee on Energy and Commerce refused to create an express private right of action for parties other than contemporaneous traders "to avoid creating an express private cause of action which might have the unintended effect of freezing the law or in any way restricting the potential rights of action which have



ability of any other theories of liability, such as aiding and abetting . . . , in appropriate circumstances.”<sup>18</sup> Accordingly, Congress enacted an anti-negative implication clause, providing that “[n]othing in this section shall be construed to limit or condition . . . the availability of any cause of action implied from a provision of [the 1934 Act].” 15 U.S.C. § 78t-1(d) (1988).<sup>19</sup>

These congressional enactments, effectively ratifying the private remedy in 1975 and then, in 1988, taking additional steps to assure its continuing integrity, supply an alternative and independent ground for recognizing the aiding and abetting action. They are also consistent with the implication of the aiding and abetting action from sources more contemporary to the 1934 Congress.

**D. The Remedy In No Way Interferes With Effective Operation Of The Securities Laws; Each Of The Hundreds Of Federal Courts Addressing The Issue Has Recognized A Civil Action For Aiding And Abetting § 10(b) Violations**

While Congress over the years has been alert to maintain the vitality of the 1934 Act in the face of evolving challenges to the policies which inform the federal securities laws, it has been the federal courts which have “accepted and exercised the principal responsibility for the continuing elaboration of the scope of the 10b-5 right and the definition of the duties it imposes.” *Musick*, 113 S. Ct. at 2089.

been implied by the courts in this area. Rather, the Committee wanted to give the courts leeway to develop such private rights of action in an expansive fashion in the future.” H.R. REP. NO. 100-910, 100th Cong., 2d Sess., 27-28 (1988).

<sup>18</sup> H.R. REP. NO. 100-910, 100th Cong., 2d Sess., 27 n.23 (1988).

<sup>19</sup> See also H.R. REP. NO. 100-910, 100th Cong., 2d Sess., 28 (1988) (recognizing implied actions and indicating that the anti-negative implication clause is intended to preserve them); 134 CONG. REC. S17218 (daily ed. Oct. 21, 1988) (statement of Sen. Proxmire) (ITSFEA not intended “to restrict the evolving law on private rights of action”).

A result of that judicial process is a history of at least 30 years in which the federal courts have widely accepted and applied the 10b-5 right to hold accountable those who substantially and culpably aid and abet a primary 10b-5 violation.<sup>20</sup> Currently, all twelve circuits have found aiding and abetting civilly actionable under § 10(b).<sup>21</sup> Our research also reflects that federal district courts have so held in no fewer than 309 published decisions where the discussion of a § 10(b) aiding and abetting claim was sufficiently significant to merit reference in the case headnotes. The importance of this acceptance is not merely an issue of “polling” the lower courts, but a pertinent and especially strong indication that the aiding and abetting

<sup>20</sup> The private action for aiding and abetting under § 10(b) was apparently first recognized as such in *Pettit v. American Stock Exchange*, 217 F. Supp. 21, 28 (S.D.N.Y. 1963), and first analyzed in detail in *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673 (N.D. Ind. 1966), *aff’d*, 417 F.2d 147 (7th Cir. 1969). However, the underpinnings of the aiding-abetting claim are even older, being essentially contemporaneous with the private right of action itself. One month after Judge Kirkpatrick’s seminal decision recognizing the 10b-5 civil action in *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), he addressed the scope of brokers’ liability in *Fry v. Schumaker*, 83 F. Supp. 476 (E.D. Pa. 1947), holding that a private action could be brought against brokers as joint tortfeasors if they “render[ed] services essential to or participat[ed] in a scheme of fraud.” *Id.* at 478. Furthermore, the private right of action as it was first established in *Kardon* expressly extended to conspiracy, another form of implied secondary liability. 69 F. Supp. at 514-15.

<sup>21</sup> See, e.g., *Cleary v. Perfectune, Inc.*, 700 F.2d 774 (1st Cir. 1983); *IIT v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980); *Landy v. FDIC*, 486 F.2d 139 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974); *Schatz v. Rosenberg*, 943 F.2d 485 (4th Cir. 1991); *Woodward v. Metro Bank*, 522 F.2d 84 (5th Cir. 1975); *Moore v. Fenez, Inc.*, 809 F.2d 297 (6th Cir.), *cert. denied sub nom. Moore v. Frost*, 483 U.S. 1006 (1987); *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490 (7th Cir. 1986); *Stokes v. Lokken*, 644 F.2d 779 (8th Cir. 1981); *Harmsen v. Smith*, 693 F.2d 932 (9th Cir. 1982), *cert. denied*, 464 U.S. 822 (1983); *DBLKM, Inc. v. Resolution Trust Corp.*, 969 F.2d 905 (10th Cir. 1992); *Woods v. Barnett Bank*, 765 F.2d 1004 (11th Cir. 1985); *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27 (D.C. Cir. 1987).

remedy in no way "detracts from the effectiveness of the 10b-5 implied action or interferes with the effective operation of the securities laws." *Musick*, 113 S. Ct. at 2091.

While twice reserving its ruling, this Court has suggested that it would recognize aiding and abetting when the issue was properly presented. *Huddleston*, 459 U.S. at 379 n.5; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 191 n.7 (1975). In *Huddleston*, the Court cited to *Merrill Lynch, Pierce, Fenner and Smith, Inc. v. Curran*, 456 U.S. 53 (1982), where it had previously explained that secondary liability for conspirators under a section of the Commodity Exchange Act analogous to § 10(b) "necessarily follows" if a private right is implied:

Having concluded that exchanges can be held accountable for breaching their statutory duties to enforce their own rules prohibiting price manipulation, it necessarily follows that those persons who are participants in a conspiracy to manipulate the market in violation of those rules are also subject to suit . . . .

*Curran*, 456 U.S. at 394 (emphasis added); *Huddleston*, 459 U.S. at 379 n.5.

It follows similarly that aiders and abettors are subject to suit under 10b-5. This rule is no more exceptional than the right to contribution recognized in *Musick* and is incremental to the 10b-5 implied right itself. When *Musick* was decided, the right to contribution under § 10(b) was, if anything, less entrenched than the aiding and abetting remedy, and had certainly not been unanimously accepted by the circuits.<sup>22</sup> Nonetheless, the Court found it significant that "the vast majority of the courts

<sup>22</sup> See, e.g., *Chutich v. Touche Ross & Co.*, 960 F.2d 721, 724 (8th Cir. 1992) (finding no right to contribution under § 10(b)); *Robin v. Doctors Offcenters Corp.*, 730 F. Supp. 122, 124-25 (N.D. Ill. 1989) (same); *In re Professional Fin. Management, Ltd.*, 683 F. Supp. 1283, 1285-87 (D. Minn. 1988) (same); *Nelson v. Craig-Hallum, Inc.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) 94,500 at 93192-93193 (D. Minn. 1989) (same); *Biben v. Card*, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) 96,512 at 92,331 n.2 (W.D. Mo. 1991) (same).

of appeals and district courts" which had considered the issue had recognized an implied right of contribution. *Musick*, 113 S.Ct. at 2091. Aiding and abetting, more than contribution, has strong roots in the common law. Finally, while contribution may at least arguably dilute the accountability of joint tortfeasors contrary to congressional intent, the aiding and abetting action ensures accountability in schemes violative of the Act.

In summary, consistent support for this cause of action is derived from consulting each of the recognized interpretive resources reviewed above—the language of the statute and the Rule, what the 1934 Congress would have intended based on the common law antecedents of the § 10(b) action, the structure of the express private remedies under the 1934 Act; legislative enactments in 1975 and 1988 which ratified and protected the aiding and abetting remedy; and the comprehensive judicial acceptance of the private cause of action. The very fact that the subject matter here is securities bespeaks an overall approach that recognizes what happened in this country in a number of areas, including securities, during the few years beginning in 1933. This is not to say simply that the SEC statutes as remedial legislation should be liberally construed, but that the courts, to the extent consistent with the words and the purpose of the statutes, should recall the change in this country from *caveat emptor* to protection of the investor. The substance of all of these interpretive sources is that the civil aiding and abetting remedy stands as an integral part of the 10b-5 action itself.

## II. RECKLESSNESS ESTABLISHES SCIENTER WHERE AN AIDER AND ABETTOR AS DID CENTRAL BANK IN THIS CASE, ACTS AFFIRMATELY AND SUBSTANTIALLY TO ASSIST A PRIMARY VIOLATION OF § 10(b)

Petitioner contends that the Tenth Circuit should have employed a "high conscious intent" standard, rather than recklessness, in connection with the scienter element of the aiding and abetting claim. For the reasons stated below, petitioner's reckless conduct, particularly under the



stringent test applied by the Tenth Circuit, correctly establishes the culpable state of mind for civil aiding and abetting liability under § 10(b).

**A. Recklessness Establishes Scienter For Civil Aiding And Abetting Under § 10(b)**

Determining the requisite state of mind for the § 10(b) action requires the same analysis used in discerning its other elements. A key question, therefore, is how the 1934 Congress would have designed the private remedy. *Musick*, 113 S. Ct. at 2089-90. Based on the language of § 10(b), the structure of the 1933 and 1934 Acts, and the common law at the time of enactment of § 10(b), Congress would have understood the scienter requirement to extend to behavior constituting an "extreme departure from the standards of ordinary care."

**1. Scienter Must Be Shown for both Primary Violations and Aiding and Abetting Violations of § 10(b)**

In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), after analyzing the language and history of § 10(b), the Court described the culpable state of mind required in civil actions against primary violators of § 10(b) as "scienter." *Id.* at 194. Scienter, the Latin term for "knowingly," must be shown both for primary violations and for aiding and abetting. The Court has so concluded in an SEC enforcement action, where the defendant was alleged to have "violated and aided and abetted violations . . . of § 10(b)," holding that scienter must be shown "regardless of the identity of the plaintiff or the nature of the remedy sought." *Aaron v. SEC*, 446 U.S. 680, 684 & 691 (1980); see also Don J. McDermott, Jr., Comment, *Liability for Aiding and Abetting Violations of Rule 10-5: The Recklessness Standard in Civil Damage Actions*, 62 TEX. L. REV. 1087, 1111 (1984) (culpable state of mind for aiding and abetting violations should be the same as the standard for primary violations); cf. *United States v. Feola*, 420 U.S. 671, 687-88 (1975)

(refusing to apply to criminal conspiracy a culpable state of mind more stringent than that required for the underlying crime.).

**2. Had It Expressly Created the Implied Right of Action, the 1934 Congress Would Have Intended Reckless Conduct to Satisfy the Scienter Requirement**

In *Hochfelder*, the Court stated that scienter "refers to a mental state embracing intent to deceive, manipulate, or defraud." 425 U.S. at 194 n.12. Finding no persuasive contrary indication in the statutory language or scheme, the Court suggested that recklessness may constitute scienter under § 10(b) because "[i]n certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some acts." *Ibid.* However, since it was negligence that was at issue in *Hochfelder*, the Court reserved decision on "whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b-5." *Ibid.*<sup>23</sup>

After *Hochfelder*, every federal circuit has concurred that recklessness satisfies the scienter element for primary violations of § 10(b).<sup>24</sup> Similarly, the circuits have

<sup>23</sup> In the seventeen years since *Hochfelder*, the Court has not ruled whether recklessness establishes scienter. See *Aaron*, 446 U.S. at 686 n.5 (reserving judgment).

<sup>24</sup> See, e.g., *Hoffman v. Estabrook & Co.*, 587 F.2d 509, 516 (1st Cir. 1978); *Rolf v. Blythe, Eastman Dillion & Co., Inc.*, 570 F.2d 38, 44-47 (2d Cir.), cert. denied, 439 U.S. 1089 (1978); *Coleco Indus. v. Berman*, 567 F.2d 569, 574 (3d Cir. 1977), cert. denied, 439 U.S. 830 (1978); *SEC v. Gotehey*, 981 F.2d 1251 (4th Cir. 1992) (text available on Westlaw), cert. denied, 113 S. Ct. 3049 (1993); *First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1314 (5th Cir. 1977), cert. denied sub nom. *Walter E. Heller & Co. v. First Virginia Bankshares*, 435 U.S. 952 (1978); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1023-24 (6th Cir. 1979); *Sunstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1039-40 (7th Cir.), cert. denied, 434 U.S. 875 (1977); *Van Dyke v. Coburn Enter., Inc.*, 873 F.2d 1094, 1100 (8th Cir. 1989); *Nelson v. Serwold*, 576 F.2d 1332,



generally agreed that recklessness establishes the scienter or "knowledge" requirement for civil aiding and abetting under § 10(b), in some cases depending upon the presence or absence of various special circumstances.<sup>25</sup> For the reasons stated below, the recklessness standard conforms with the manner in which the 1934 Congress itself would have spelled out this element of the private remedy.

1337 (9th Cir.), *cert. denied*, 439 U.S. 970 (1978); *Hackbart v. Holmes*, 675 F.2d 1114, 1117 (10th Cir. 1982); *Woods v. Barnett Bank*, 765 F.2d 1004, 1010 (11th Cir. 1985); *Dirks v. SEC*, 681 F.2d 824, 844-845, n.27 (D.C. Cir. 1982), *rev'd on other grounds*, 463 U.S. 646 (1983).

<sup>25</sup> See, e.g., *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983) (recklessness standard applied where defendant has duty to disclose); *Rolf v. Blyth, Eastman Dillion & Co.*, 570 F.2d 38, 44-47 (2d Cir. 1978) (applying recklessness standard to aiding and abetting), *cert. denied*, 439 U.S. 1039 (1978); *Gould v. American-Hawaiian S.S. Co.*, 535 F.2d 761, 780 (3d Cir. 1976) ("requirement of knowledge may be less strict where the alleged aider and abettor derives benefits from the wrongdoing"); *Schatz v. Rosenberg*, 943 F.2d 485, 496 (4th Cir. 1991), *cert. denied sub nom. Schatz v. Weinberg & Green*, 112 S. Ct. 1475 (1992) (non-action case holding that recklessness applies where defendant owes duty to plaintiff); *Woodward v. Metro Bank*, 522 F.2d 84, 95 (5th Cir. 1975) (applying sliding scale scienter requirement to aiding and abetting); *Ackerman v. Schwartz*, 947 F.2d 841, 847 (7th Cir. 1991) ("[I]f [the alleged aider and abettor] acted recklessly, he had the mental state that identifies fraud under . . . [§ 10(b) and Rule 10b-5]."); *Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1126 (7th Cir. 1990) (recklessness standard applied), *cert. denied*, 111 S. Ct. 1317 (1991); *Stokes v. Lokken*, 644 F.2d 779, 783 (8th Cir. 1981) (applying recklessness standard without fully defining culpable state of mind); *Levine v. Diamanthuset*, 950 F.2d 1478, 1483 (9th Cir. 1991) (recklessness standard applied); *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d 646, 652-53 (9th Cir. 1988) (same), *cert. denied*, 493 U.S. 1002 (1989); *DBLKM, Inc. v. Resolution Trust Corp.*, 969 F.2d 905, 908 (10th Cir. 1992) (applying recklessness standard); *Woods v. Barnett Bank*, 765 F.2d 1004, 1010 (11th Cir. 1985) (applying sliding scale test); *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 36 (D.C. Cir. 1987) (recklessness applies where defendant violates duty).

a. *The Language of § 10(b) Manifests a Congressional Intent to Prohibit Reckless Conduct, and Rule 10b-5 Reflects a Similar Purpose of the SEC*

Unlike "actual intent," the recklessness standard for scienter encompasses the full range of § 10(b)'s descriptive language, from which the Court in *Hochfelder* derived the culpable state of mind intended by the 1934 Congress. 425 U.S. at 197-206. The Court concluded that "[t]he words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that § 10(b) was intended to proscribe knowing or intentional misconduct." *Id.* at 198. While "actual intent" clearly meets these criteria, it is not synonymous with them. As the Court expressly noted, "knowing or intentional misconduct" could include recklessness. 425 U.S. at 194 n.12; see also *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 44 (2d Cir.) (at common law, the word "knowing" included reckless conduct (citing W. PROSSER, *THE LAW OF TORTS* § 107, at 700 (4th ed. 1971))), *cert. denied*, 439 U.S. 1039 (1978). "Actual malice" and "calculated falsehood," as these words are used in the Court's libel decisions, include "reckless disregard of whether [a defamatory statement] was false or not." *New York Times Co. v. Sullivan*, 376 U.S. 254, 279-80 (1964); *Garrison v. Louisiana*, 379 U.S. 64, 75 (1964); *Curtis Publishing Co. v. Butts*, 388 U.S. 130, 153 (1967). Similarly, the word "willful" (which the Court equated with the word "intentional") as used in the Fair Labor Standards Act of 1938, also includes "reckless disregard." *McLaughlin v. Richland Shoe Co.*, 486 U.S. 128, 133 (1988).<sup>26</sup>

More importantly, the word "deceptive" is itself a term of art referring to the common law tort of deceit (also

<sup>26</sup> See also *Hazen Paper Co. v. Biggins*, 113 S. Ct. 1701, 1710 (1993) ("willful" within the meaning of § 7(b) of the Age Discrimination in Employment Act of 1967 includes "reckless disregard"); *Trans World Airlines v. Thurston*, 469 U.S. 111, 128-29 (1985) (same).

known as fraud and misrepresentation). Without question, the tort of deceit included reckless behavior, see IACPA Brief at 22, and this principle was prominently and repeatedly woven through the common law by the time the 1934 Congress enacted § 10(b).<sup>27</sup>

<sup>27</sup> See *Cooper v. Schlesinger*, 111 U.S. 148, 155 (1884); *Lehigh Zinc & Iron Co. v. Baumford*, 150 U.S. 665, 673 (1893); see also *Peek v. Derry*, 14 App. Cas. 337 (H.L. 1889); *Simon v. Goodyear Metallic Rubber Shoe Co.*, 105 F. 573, 580-81 (6th Cir. 1900); *Hindman v. First Nat. Bank of Louisville*, 112 F. 931, 944-45 (6th Cir.), cert. denied, 186 U.S. 483 (1902); *Einstein, Hirsh & Co. v. Marshall & Conley*, 58 Ala. 153, 163 (1877); *Colvin v. Delaney*, 101 Conn. 73, A. 841, 843 (1924); *Schoefield Gear & Pulley Co. v. Schoefield*, 71 Conn. 1, 18-19, 40 A. 1046, 1051 (1898); *Johnson v. Holderman*, 30 Idaho 691, 694-95, 167 P. 1030, 1031 (1917); *Parker v. Herron*, 30 Idaho 327, 331, 164 P. 1013, 1014 (1917); *Kirkpatrick v. Reeves*, 121 Ind. 280, 282, 22 N.E. 139, 140 (1889); *Diamond v. Peace River Land & Dev. Co.*, 182 Iowa 400, 441, 165 N.W. 1032, 1035 (1918); *Davis v. Central Land Co.*, 162 Iowa 269, 275, 143 N.W. 1073, 1075 (1913); *Hubbard v. Weare*, 79 Iowa 678, 686, 44 N.W. 915, 918 (1890); *Bice v. Nelson*, 105 Kan. 23, 26, 180 P. 206, 207 (1919); *McGuffin v. Smith*, 215 Ky. 606, 612, 286 S.W. 884, 886 (1926); *Richards v. Foss*, 126 Me. 413, 139 A. 231, 232 (1927); *Goodwin v. Fall*, 102 Me. 353, 66 A. 727, 730 (1907); *Cahill v. Applegarth*, 98 Md. 493, 502-503, 56 A. 794, 797 (1904); *Weeks v. Currier*, 172 Mass. 53, 55, 51 N.E. 416, 417 (1898); *Chatham Furnance Co. v. Moffatt*, 147 Mass. 403, 404, 18 N.E. 168, 169 (1888); *Litchfield v. Hutchinson*, 117 Mass. 195, 197-98 (1875); *Beebe v. Knapp*, 28 Mich. 53, 76 (1873); *Bullitt v. Farrar*, 42 Minn. 8, 11, 43 N.W. 566, 567 (1889); *Lynch v. Mercantile Trust Co.*, 18 F. 486, 487-88 (C.C. Minn. 1883); *Vincent v. Corbitt*, 94 Miss. 46, 47 So. 641, 643 (1908); *Luikart v. Miller*, 48 S.W.2d 867, 868 (Mo. 1932); *Miller v. Rankin*, 136 Mo. App. 426, 117 S.W. 641 (Mo. Ct. App. 1909); *Hamlin v. Abell*, 120 Mo. 188, 203, 25 S.W. 516, 519 (1893); *Shackett v. Bickford*, 47 N.H. 57, 65 A. 252, 254 (1906); *Bingham v. Fish*, 86 N.J.L. 316, 319, 90 A. 1106, 1107 (N.J. 1914); *Hadcock v. Osmer*, 153 N.Y. 604, 608, 47 N.E. 923, 924 (1897); *Kountze v. Kennedy*, 147 N.Y. 124, 129, 41 N.E. 414, 415 (1895); *Indianapolis, P.&C.R.R. Co. v. Tyng*, 63 N.Y. 653, 655 (1876); *Dieterle v. Harris*, 66 Okla. 314, 315, 169 P. 873, 874 (1917); *Jackman v. Northwestern Trust Co.*, 87 Or. 209, 170 P. 304, 305 (1918); *Griswold v. Gebbie*, 126 Pa. 353, 363-64, 17 A. 673, 674 (1889); *Stuck v. Delta Land & Water Co.*, 63 Utah 495, 227 P. 791, 795 (1924); THOMAS M. COOLEY,

In promulgating Rule 10b-5, the SEC, too, intended to reach reckless conduct.<sup>28</sup> The Court has observed that at least one, if not two, of the Rule's three subsections are worded broadly enough to extend even to unintentional conduct. *Hochfelder*, 425 U.S. at 212; *Aaron v. SEC*, 446 U.S. 680, 696 (1980). To the extent Rule 10b-5 is ambiguous, the Commission's position that the Rule addresses reckless conduct for both primary violations and aiding and abetting is entitled to substantial weight. See *Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 837, 843 (1984); *Chiarella v. United States*, 445 U.S. 222, 226-27 (1980).

b. *The Legislative History of § 10(b) Shows that Congress Intended to Prohibit Reckless Conduct*

Reviewing the legislative history of § 10(b), the *Hochfelder* Court found "an overall congressional intent to prevent 'manipulative and deceptive practices which . . . fulfill no useful function' and to create private actions for damages stemming from 'illicit practices,' where the defendant has not acted in good faith." 425 U.S. at 202-206 (emphasis added). The Court concluded that "[t]here is no indication that Congress intended anyone to be made liable for such practices unless he acted other than in good faith. The catchall provision of § 10(b) should be interpreted no more broadly." *Id.* at 206. To find a culpable mental state where a defendant acts 'other than in good faith' requires a considerably more expansive

A TREATISE ON THE LAW OF TORTS, § 300, at 598 *et seq.* (3d ed. 1930); FOWLER V. HARPER, A TREATISE ON THE LAW OF TORTS, § 221 (1933); FRANCES M. BURDICK, THE LAW OF TORTS: A CONCISE TREATISE ON CIVIL LIABILITY FOR ACTIONABLE WRONGS TO PERSON AND PROPERTY, § 391, at 444-45 (4th ed. 1926); FREDERICK POLLOCK, A TREATISE ON THE LAW OF TORTS IN OBLIGATIONS ARISING FROM CIVIL WRONGS IN THE COMMON LAW, at 355, 367-68 (3d ed. 1894).

<sup>28</sup> For the text of Rule 10b-5, see *supra* note 8.



standard than "high conscious intent." See *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 46 n.15 (2d Cir.) ("Reckless behavior hardly constitutes good faith. Since good faith does not constitute a defense to reckless or intentional conduct, a recklessness standard is fully consistent with *Hochfelder* on its own terms."), *cert. denied*, 439 U.S. 1039 (1978); BLACK'S LAW DICTIONARY 693 (6th ed. 1990) (Good faith requires "[h]onesty of intention, and freedom from knowledge of circumstances which ought to put the holder upon inquiry.").

c. *Recklessness Is Consistent with the Express Private Remedies and with the Structure of the Acts*

The range of circumstances covered by the eight express private remedies at §§ 11, 12 and 15 of the 1933 Act and §§ 9, 16, 18, 20 and 20A of the 1934 Act shows the purpose of Congress to create civil liability for a wide variety of wrongdoing, from strictly liable activity to behavior bereft of good faith such as recklessness. None of these remedies requires a showing higher than recklessness. Section 11 of the 1933 Act makes issuers strictly liable for false or misleading registration statements and provides only a "due diligence" defense for other culpable parties. 15 U.S.C. § 77k (1988). Section 12 of the 1933 Act places the burden of proof on the seller or offeror of a security to show that he or she "in the exercise of reasonable care could not have known" that a prospectus or oral communication was misleading. 15 U.S.C. § 771 (1988). Section 15 of the 1933 Act incorporates a negligence standard, under which controlling persons are civilly liable unless they had no "reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist." 15 U.S.C. § 77o (1988).<sup>29</sup> Section 9 of the 1934 Act holds civilly liable anyone who "willfully"—a term which the Court

<sup>29</sup> The Court has already noted that, at a minimum, "each of the express civil remedies in the 1933 Act allow[s] recovery for negligent conduct." *Hochfelder*, 425 U.S. at 208.

has held to comprehend at least recklessness in other statutory contexts<sup>30</sup>—participates in the manipulation of securities prices.<sup>31</sup> 15 U.S.C. § 78i (1988 & Supp. III 1991). Section 16 of the 1934 Act creates strict liability under most circumstances, and a mere "good faith" defense under others. 15 U.S.C. § 78p(2) (1988). Section 18 of the 1934 Act places the burden on persons making misleading statements to prove that they "acted in good

<sup>30</sup> See, e.g., *Hazen Paper Co. v. Biggins*, 113 S. Ct. 1701, 1710 (1993); *McLaughlin v. Richland Shoe Co.*, 486 U.S. 128, 133 (1988); *Trans World Airlines v. Thurston*, 469 U.S. 111, 128-29 (1985).

<sup>31</sup> See IX LOSS & SELIGMAN, SECURITIES REGULATION 4282 (3d ed. 1991) (Regarding the word "willfully" in § 9(e), "[o]rdinarily, on the assumption that there is any proof that the defendant participated at all in the manipulation, this requirement should not create much trouble in view of the loose way the courts have interpreted 'willfully' even in criminal cases and in broker-deal revocation proceedings under the 1934 Act." (footnote omitted)); see also *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 46 (2d Cir.) ("Similarly, securities law cases have recognized that recklessness may serve as a surrogate concept for willful fraud."), *cert. denied*, 439 U.S. 1039 (1978). Respecting the use of the word "willfully" in criminal contexts, one commentator has explained that the term equates with the common law's general intent, corresponding to recklessness, and not with specific intent:

The criminal law's ambiguity on the crucial issue of intent spawned an influential reform effort in the form of the Model Penal Code prepared under the auspices of the American Law Institute. . . .

Synonyms for "purposely," sitting at the top level of culpability in the Model Penal Code's descending hierarchy, are "intentionally," "with intent," "design," or "with design." "Willfully," which has been termed "a word of many meanings," is equated with "knowingly," not "purposely." "Purposely" generally correlates with the common law's "specific intent." Both "knowingly" and "recklessly" correspond, according to the Model Code's drafters, with the "the common law requirement of 'general intent.'" The general intent requirement at common law was not a rigorous one.

John P. Freeman, *Scienter in Professional Liability Cases*, 42 S.C. L. REV. 785, 829 (1991) (footnotes omitted).



faith and had no knowledge that such statement was false or misleading." 15 U.S.C. § 78r (1988). Section 20 of the 1934 Act holds controlling persons liable "unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." 15 U.S.C. § 78t(a) (1988). Section 20A of the 1934 Act makes insider trading violations civilly actionable without creating a defense based on good faith or some other mental state. 15 U.S.C. § 78t-1 (1988).

Since reckless behavior is civilly actionable under each of the express remedies, the 1934 Congress would have intended an analogous state of mind to establish scienter for aiding and abetting 10b-5 violations. *Cf. In re Investors Funding Corp. of New York Sec. Litig.*, 523 F. Supp. 533, 542 & n.4 (S.D.N.Y. 1980) (recklessness sufficient to prove aiding and abetting under § 18 of the 1934 Act); *SEC v. Militano*, 773 F. Supp. 589 (S.D.N.Y. 1991) (recklessness is sufficient to prove aiding and abetting under § 9 of the 1934 Act). Indeed, Congress made secondarily liable parties civilly responsible for their reckless conduct when it expressly provided for secondary liability under the Acts. Unlike the other private remedies, § 15 of the 1933 Act and § 20 of the 1934 Act are directed exclusively to secondary liability.<sup>32</sup> Congress' creation of liability for reckless behavior of controlling persons under these provisions<sup>33</sup> (including recklessness by persons or parties who control entities that violate § 10(b)) force-

<sup>32</sup> Petitioner argues against the private action for aiding and abetting under § 10(b) on the ground that secondary liability cannot be based on a primary violation of § 15 of the 1933 Act and § 20 of the 1934 Act. This ignores that these sections involve only secondary liability. There is no reason to suppose that Congress would even have considered providing for a remedy directed to "aiding and abetting of secondary liability."

<sup>33</sup> See, e.g., *Hochfelder*, 425 U.S. at 208 (under § 15 controlling persons are liable for negligent conduct); *G.A. Thompson & Co. v. Partridge*, 636 F.2d 945, 959 (5th Cir. 1981) (§ 20 extends to reckless conduct).

fully suggests that Congress also would have intended aiders and abettors to be civilly liable for recklessness under the private § 10(b) remedy.

d. *Congress Would Not Have Required Actual or "High Conscious" Intent for Civil Liability, Since this Would Have Confined the 10b-5 Action More Narrowly than the Common Law Remedy*

Reckless conduct was civilly actionable by victims of fraud when the 1934 Congress enacted § 10(b). See, e.g., THOMAS M. COOLEY, A TREATISE ON THE LAW OF TORTS OR THE WRONGS WHICH ARISE INDEPENDENTLY OF CONTRACT § 361, at 603 (4th ed. 1932); see also cases cited, *supra* note 27. Similarly with respect to aiding and abetting, rather than requiring a strict showing of actual knowledge, common law courts at the time § 10(b) was enacted had begun imposing aiding and abetting liability based on "constructive knowledge." See *White v. Moran*, 134 Ill. App. 480, 491 (1907) ("If [the alleged aiders and abettors] had actual or constructive knowledge of the fraudulent character of the enterprise, and with such knowledge, aided and abetted in its furtherance, and by means of false and untrue representations induced appellee to invest therein, they were *in pari delicto* with White in the fraud and deceit practiced and equally liable with him for any damages occasioned to appellee." (emphasis added)). In a related context, transferees of fraudulent conveyances were liable for their substantial assistance to the fraud, so long as they acted either with actual knowledge, constructive knowledge, or notice of the fraud. See, e.g., *Svalina v. Saravana*, 341 Ill. 236, 250, 173 N.E. 281, 286 (1930) ("even though the grantee pays a valuable, adequate, and full consideration, yet, if the grantor sells for the purpose of defeating the claims of creditors and the grantee knowingly assists in such fraudulent intent, or even has notice thereof, he will be regarded as a participant in the fraud" (emphasis added)); *Beidler*

*v. Crane*, 135 Ill. 92, 99, 25 N.E. 655, 657 (1890) (even notice of fraudulent transfer makes participant liable, "for the law never allows one man to assist in cheating another"); *Merchant & Farmers' Bank v. Harris*, 113 Ark. 100, 108, 167 S.W. 706, 708 (1914) (grantee "charged with notice [of fraud], . . . must be held to have assisted [the primary wrongdoer] in carrying out his fraudulent purpose"). While some courts applied the "knowledge" element of aiding and abetting without addressing or explaining its scope, the courts which specified that the remedy was applicable to circumstances evidencing absence of good faith should be given special weight. See LOSS, FUNDAMENTALS OF SECURITIES REGULATIONS 812 (1963) ("Because of the legislative background it seems reasonable to assume at the very least that the most liberal common law views on these questions should govern under the statutes").<sup>34</sup>

<sup>34</sup> Petitioner argues that the criminal model should prevail over the civil model for at least the knowledge element of aiding and abetting. This is especially unpersuasive because of the punitive purpose of the criminal law as compared to the compensatory and remedial objectives of the private remedy. As one commentator has noted in support of applying civil, rather than criminal, aiding and abetting principles to the private § 10(b) action:

The criminal standards for aiding and abetting focus heavily on the intentional nature of the conduct. This is appropriate because *mens rea* is an essential element for criminal liability. Tort liability, on the other hand, merely seeks to apportion responsibility for harm.

Kuehnle, *supra* note 10, at 322-23.

It is, in any event, far from clear that the Court's formulation of the requisite culpable state of mind for criminal aiding and abetting would not also extend to reckless conduct. See *Nye & Nissen v. United States*, 336 U.S. 613, 619 (1949) ("in order to aid and abet another to commit a crime it is necessary that a defendant 'in some sense associate himself with the venture, that he participate in it as in something that he wishes to bring about, that he seek by his action to make it succeed.'" (quoting *United States v. Peoni*, 100 F.2d 401, 402 (2d Cir. 1938))); *United States v. Sarantos*, 455 F.2d 877, 880-82 (2d Cir. 1972) (upholding jury instruction basing aiding and abetting liability on a "reckless dis-

While the common law remedies for securities fraud cannot be strictly followed, the parameters of § 10(b) must account for any differences. See *Basic Inc. v. Levinson*, 485 U.S. 224, 243-44 (1988); see also *Basic Inc.*, 485 U.S. at 253 (White, J., dissenting) (the common law is a "guidepost" for interpreting § 10(b)). Petitioner and supporting amici are quick to point out that the federal securities laws are "light years away" from their common law antecedents; for precisely that reason, however, it should also be beyond doubt that the 1934 Congress would not have intended its catchall anti-fraud provision to be light years *less* effectual in curbing fraud than the common law. Were victims of unlawful securities schemes to be routinely burdened with the task of proving specific fraudulent intent in complex transactions,<sup>35</sup> often involv-

regard of the falsity of the statements or a conscious effort to avoid learning the truth"); *United States v. Hughes*, 891 F.2d 597, 600 (6th Cir. 1989) ("reckless disregard" establishes criminal aiding and abetting); Freeman, *supra* note 31, at 833 ("The generally accepted common-law position views recklessness as a sufficient level of criminal intent . . .").

<sup>35</sup> It is not unusual in securities fraud cases that parties or experts will resist at every turn, and often in reliance on not particularly meaningful distinctions, plaintiff's effort to prove scienter; a typical example is the following exchange from a discovery deposition of Central Bank's trust officer:

Q: [Y]ou knew that the real estate market in Colorado Springs was in a state of decline?

A: [CENTRAL BANK TRUST OFFICER CRANDALL] I did not know that. I had been advised that or heard of it and it had been discussed. But I didn't know that.

Q: I'm not an expert on the English language, and I was using the word "knew" or "know" the way we do in common parlance. Who had advised you that the real estate market was in a state of decline?

A: [The Dain Bosworth Representative] had called me and advised me that based on whatever work he had done . . . there was a decline in property values in El Paso County.

J.A. 63-64. Accordingly, the Court has noted that "the difficulty of proving the defendant's state of mind supports a lower standard of proof" in 10b-5 fraud case. *Huddleston*, 459 U.S. at 692 n.30.



ing corporate defendants employing elaborately diffused levels of authority and responsibility, there would be little reason for them to turn from the common law remedies to § 10(b). See *Rolf v. Blyth, Eastman Dillion & Co.*, 570 F.2d 38, 47 (2d Cir.) ("To require in all types of 10b-5 cases that a factfinder must find a specific intent to deceive or defraud would for all intents and purposes disembowel the private cause of action under § 10(b)."), *cert. denied*, 439 U.S. 1039 (1978). The evidence is that the 1934 Congress would not, and did not, intend this result.

**B. The Question Of Petitioner's Duty To Act Or To Disclose Is Irrelevant To The Scienter Required For Aiding And Abetting; This Is Particularly The Case Where, As Here, A Defendant Affirmatively Assists A Fraudulent Scheme**

Petitioner argues in the alternative that the scienter requirement for aiding and abetting ought to vary or "slide" depending upon a defendant's duty to disclose or act. Petitioner ignores, however, this Court's holdings, most recently in *Musick*, pointing to the importance of how the 1934 Congress would have defined the scienter element of a private right under § 10(b).

Applying that test, it is evident that Congress did not intend scienter as a fluctuating requirement, and would not have so structured the 10b-5 action. A "sliding" knowledge element has no basis in the language or history of § 10(b), nor do any of the express private remedies under the 1933 or 1934 Acts purport to alter the standard for the requisite state of mind depending upon the presence or absence of disclosure duties. There is no reason to suppose that the 1934 Congress would have shaped the 10b-5 private action in this manner when it had failed to do so anywhere else in the federal securities laws.<sup>36</sup>

<sup>36</sup> Cf. *McDermett*, *supra* page 30, at 1108 ("The courts that have limited the application of the recklessness standard in aiding and

To the contrary, there is substantial reason why the scienter element would *not* have been left vaguely to depend on whether the defendant might ultimately prevail on an argument for "no disclosure duty." This Court has already rejected the idea of overlaying a duty/no duty "distinction" on the materiality element of primary liability. See *Basic Inc. v. Levinson*, 485 U.S. 240, n.18 ("Devising two different standards of materiality, one for situations where insiders have traded in abrogation of their duty to disclose or abstain (or for that matter when any disclosure has been breached), and another covering affirmative misrepresentations by those under no duty to disclose (but under the ever-present duty not to mislead), would effectively collapse the materiality requirement into the analysis of defendant's disclosure duties."). Similarly as to the scienter requirement, the application of a "duty to disclose" standard would collapse that element into an analysis (and almost certainly an elusive one) of disclosure obligations.

Although some courts have identified still other special circumstances as determining the required level of scienter,<sup>37</sup> these matters are in reality not different from the evidentiary factors subsumed within the recklessness standard itself.<sup>38</sup> When incorporated into separate "tests"

abetting cases have not stated a clear rationale for requiring a duty to disclose.").

<sup>37</sup> A number of lower courts vary the degree of knowledge required for § 10(b) aiding and abetting based on such factors as duty to disclose or to act, whether the aider and abettor's conduct was "outside the daily grist," the proximity of the aider and abettor to the fraud, and the nature of the aider and abettor's alleged wrongdoing. See, e.g., *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 776-79 (1st Cir. 1983) (where assistance is by "inaction and silence," actual knowledge must be shown to support aiding and abetting); *Woodward v. Metro Bank*, 522 F.2d 84, 95 (5th Cir. 1975) ("The scienter requirement scales upward when activity is more remote." (footnote omitted)).

<sup>38</sup> The recklessness standard already permits the finder of fact to weigh any circumstantial evidence of intent when determining



or "sliding" standards, such factors become unworkable and confusing. See Freeman, *supra* note 31, at 808-18 (explaining the myriad problems arising from varying the knowledge standard, and suggesting uniform application of recklessness standard); McDermott, *supra* p. 30, at 1111-14 (suggesting a uniform recklessness standard for 10b-5 aiding and abetting).

Even had the 1934 Congress prescribed some circumstances where disclosure duties might condition the availability of the aiding and abetting remedy, petitioner's affirmative role in delaying a correct appraisal of the collateral for the 1988 bonds, when petitioner's own in-house expert had concluded that the appraisal unjustifiably overstated the value of the collateral, makes irrelevant an analysis of preexisting "duties to disclose." Central Bank was an actor, not a passive bystander; a duty arose from that conduct. See, *Ackerman v. Schwartz*, 947 F.2d 841, 848 (7th Cir. 1981) ("Although the lack of duty to investors means that [the alleged aider and abettor] had no obligation to blow the whistle and none to correct a letter he had not authorized to be circulated in the first place . . ., [he] cannot evade responsibility to the extent he permitted the [primary violators] to release his letter." (citations omitted)); *FDIC v. First Interstate Bank of Des Moines, N.A.*, 885 F.2d 423, 432-33 (8th Cir. 1989); *Levine v. Diamantheset, Inc.*, 950 F.2d 1478, 1485 n.4 (9th Cir. 1991) ("[W]e do not discuss the

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whether the defendant has acted recklessly. Kuehnle, *supra* note 6, at 330. As Mr. Kuehnle suggests:

[I]nstead of treating recklessness as the appropriate standard only under certain circumstances, at least where assistance is through action, it may be better to state that recklessness generally is appropriate and that the totality of circumstances must be considered to determine whether the aider and abettor had knowledge equivalent to recklessness.

*Id.* at 330; see also Freeman, *supra* note 31, at 844-55 (explaining how various factors are relevant to proving recklessness).

[aider and abettor's duty to disclose] because [its] aiding and abetting liability is premised in part not on silence, but on actual misrepresentations."); *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d 646, 652-53 (9th Cir. 1988) ("The secondary violator's duty to disclose may arise from a 'knowing assistance of or participation in a fraudulent scheme.'" (quoting *Harmsen v. Smith*, 693 F.2d 932 (9th Cir. 1982), *cert. denied*, 464 U.S. 822 (1983)), *cert. denied*, 493 U.S. 1002 (1989)); *Cf. Bate-man Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 313 (1985) (tippee's active participation creates duty); *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 152 (1972) (duty arises under § 10(b) from "active" conduct); W. PROSSER, *THE LAW OF TORTS* 339 (3d ed. 1964) ("If there is no duty to come to the assistance of a person in difficulty or peril, there is at least a duty to avoid any affirmative acts which make his situation worse when we cross the line into the field of 'misfeasance' liability is far easier to find . . ."). The requisite state of mind for the liability of a nonfiduciary who actively assists securities fraud should be no different from the culpable mental state of a fiduciary who passively assists securities fraud in violation of a preexisting duty to act or to disclose. *Cf. Aaron v. SEC*, 446 U.S. 680, 695 (1980) (Section 10(b) "applies with equal force to both fiduciary and nonfiduciary transactions in securities.").

In summary, unlike "high conscious intent" or "actual knowledge," recklessness, while itself a stringent standard, does not impose unrealistic burdens of proof upon an already complex private action. Recklessness also has a lengthy, tested history of application and of interpretation in the common law of deceit, and it properly permits consideration by the trier of fact of other circumstances pertinent to determining the defendant's state of mind. The recklessness standard meets fully the criteria for assuring that the design of the 10b-5 aiding and abetting remedy is derived from congressional intent, as that intent is pre-

sented by the language, structure and purposes of the 1934 Act.

**CONCLUSION**

For the foregoing reasons, the judgment of the Tenth Circuit should be affirmed, and the case should be remanded for trial in the federal district court.

Respectfully submitted,

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September 10, 1993

No. 92-854

Supreme Court, U.S.  
**FILED**  
**OCT 13 1993**  
OFFICE OF THE CLERK

In The  
**Supreme Court of the United States**  
October Term, 1993

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CENTRAL BANK OF DENVER, N.A.,  
*Petitioner,*  
v.

FIRST INTERSTATE BANK OF DENVER, N.A. and  
JACK K. NABER,  
*Respondents.*

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On Writ Of Certiorari To The  
United States Court Of Appeals  
For The Tenth Circuit

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REPLY BRIEF FOR PETITIONER

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## REPLY BRIEF FOR PETITIONER

## I. THERE IS NO IMPLIED PRIVATE RIGHT OF ACTION FOR AIDING AND ABETTING VIOLATIONS OF SECTION 10(b) AND RULE 10b-5.

At one time, this Court was willing to recognize implied private rights of action whenever it felt they might further the protection of investors. The Court considered it “the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose.” *J.I. Case Co. v. Borak*, 377 U.S. 426, 433 (1964). In the nearly thirty years since that statement, the Court has moved dramatically away from this expansive approach to implied rights. The Court recognized the importance of the intent of Congress in *Cort v. Ash*, 422 U.S. 66, 78 (1975), and later, in *Touche Ross & Co. v. Redington*, 442 U.S. 560, 575-76 (1979), deemed this to be the central inquiry in determining an implied private right of action. See *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2763-64 (1991). Today Respondents, the Securities and Exchange Commission, and Respondents’ amici ask this Court to return to 1964.<sup>1</sup> Although they offer some tortured reasoning to show that Congress actually incorporated aiding and abetting into § 10(b) in 1934, albeit not expressly, and has since condoned the implication of such a private right, the unmistakable thrust of their argument is that aiding and abetting is an effective tool for enforcing the securities laws. This is a determination best left to Congress, and Congress has as yet failed to create a right of action against aiders and abettors outside the criminal and disciplinary contexts.

## A. The Language Of The 1934 Act Does Not Provide A Private Right Of Action Against Aiders And Abettors.

Section 10(b) prohibits “any person, directly or indirectly” from using or employing “any manipulative or deceptive device

<sup>1</sup> Respondents even go so far as to assert that the “post-1975 test” should not be used in § 10(b) cases, because it “could only lead to a hodgepodge of inconsistent rules of law.” (Resp. Br. 11.) If Respondents are correct, it is difficult to understand why the *Cort v. Ash* and *Touche Ross* standards were created at all.

or contrivance" in connection with sales of securities. Respondents and the Commission suggest that the "directly or indirectly" language is intended to reach aiders and abettors. (Resp. Br. 15; SEC Br. 8.) However, "there is no support for the proposition that Congress intended the 'directly or indirectly' language to encompass secondary liability. The statutory scheme suggests the opposite." Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Cal. L. Rev. 80, 94 n.83 (1981).

The "directly or indirectly" language is better understood as intended not to create secondary liability against aiders and abettors, but instead to prevent the primary violator from immunizing himself from liability by acting through an agent<sup>2</sup> or other instrumentality:

Although Rule 10b-5 provides for liability when the primary party perpetrates a violation indirectly, this is not secondary liability. Perpetrating an indirect Rule 10b-5 violation might consist of using an unwilling instrumentality to consummate the fraud. A secondary party, on the other hand, may not partake in the fraud, but rather may simply fail to intervene to stop it.

<sup>2</sup> The discussion in the most recent of the three cases cited by the Commission in support of its assertion that "directly or indirectly" refers to aiding and abetting is limited to the vicarious liability of a principal for the actions of an agent. *In re Atlantic Financial Management, Inc.*, 784 F.2d 29 (1st Cir. 1986), *cert. denied*, 481 U.S. 1072 (1987). This and the other cases cited by the Commission are consistent with the view that the phrase "directly or indirectly" is intended to prevent a primary violator from avoiding liability by acting through an agent or other instrumentality. See *SEC v. Universal Major Indus. Corp.*, 546 F.2d 1044, 1046 (2d Cir. 1976) (holding that a defendant in an action under § 5 of the 1933 Act need not be "the individual who actually consummated the sale"), *cert. denied*, 434 U.S. 834 (1977); *Geo. H. McFadden & Bro., Inc. v. Home-Stake Prod. Co.*, 295 F. Supp. 587 (N.D. Okla. 1968) (holding that privity is not essential in an action under Rule 10b-5). In general, lower courts have not concluded that the statutory language of § 10(b) encompasses aiding and abetting, "but rather have relied on various common law doctrines as the basis for secondary liability." Fischel, *supra*.

John H. Karnes, Jr., *Lenders' Liability for Aiding and Abetting Rule 10b-5 Violations: The Knowledge Standard*, 41 Sw. L.J. 925, 928 n.13 (1988).<sup>3</sup>

Respondents' and the Commission's assertion that "directly or indirectly" refers to aiding and abetting a primary violation cannot survive a review of Congress' use of the phrase elsewhere in the 1934 Act. Particularly instructive is § 20, which creates express secondary liability against "[e]very person who, *directly or indirectly*, controls any person liable under any provision under this title or of any rule or regulation thereunder." 15 U.S.C. § 78t(a) (1988) (emphasis added). Use of the phrase "directly or indirectly" can hardly be intended to impose aiding and abetting liability or any other form of secondary liability based on a primary violation of the statute, since the statute itself is directed only to secondary violations of the securities laws. As Respondents themselves point out in reference to the control person provision, "[t]here is no reason to suppose that Congress would even have considered providing for a remedy directed to 'aiding and abetting of secondary liability.'" (Resp. Br. 38 n.32.)<sup>4</sup> Respondents apparently agree that the phrase "directly

<sup>3</sup> Legislative history cited by Respondents and its amici supports this interpretation of the "direct or indirect" language. The House Report concerning the Insider Trading Sanctions Act of 1984, in explaining why secondary liability under the proposed legislation was to be sharply limited, distinguished between aiding and abetting and indirect primary violations:

[I]f the board of directors of a corporation, while having material nonpublic information, directed an employee to trade for the corporation's account, the corporation itself would be liable for the penalty. In that situation, the corporation *would not be an aider and abettor, but would, in fact, be a direct violator* who traded on the inside information. . . . This result proceeds from the principle, recognized in section 20(b) of the Exchange Act, that *a person may not do indirectly what cannot be done directly*.

H.R. Rep. No. 355, 98th Cong., 2d Sess. 10-11 (1983), *reprinted in* 1984 U.S.C.A.N. 2274, 2283-84 (emphasis added).

<sup>4</sup> Respondents make this observation in response to an argument never advanced in Central Bank's opening brief.

or indirectly" in this provision cannot be read as synonymous with aiding and abetting.<sup>5</sup>

Aiding and abetting language is also conspicuously absent from §§ 9 and 18 of the 1934 Act, the civil liability provisions to which the Court looked for guidance in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773 (1991), and *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 113 S. Ct. 2085 (1993). Section 9(e) creates liability against "[a]ny person who willfully participates in any act or transaction in violation of" the statute's prohibitions on manipulation of security prices. 15 U.S.C. § 78i(e) (1988). The Commission asserts without any supporting authority that the term "participates" in this provision "plainly encompasses aiding and abetting." (SEC Br. 9.) The statutory structure of the 1934 Act again counsels against the Commission's presumption that "participates" is used in lieu of the words "aids" and "abets." Section 15(b) of the 1934 Act in one paragraph expressly allows the Commission to censure aiders and abettors, 15 U.S.C. § 78o(b)(4)(E), and in another paragraph grants the Commission certain powers over "any person participating, or, at the time of the alleged misconduct, who was participating, in an offering of any penny stock." 15 U.S.C. § 78o(b)(6)(A). Participation in a stock transaction and aiding and abetting are treated as separate concepts. As the statute goes on to make clear, participation contemplates some sort of primary role in the transaction, such as acting as a promoter, finder, consultant, or agent. 15 U.S.C. § 78o(b)(6)(C). This Court has similarly treated participation and aiding and abetting as distinct concepts under the securities laws. See *Pinter v. Dahl*, 486 U.S. 622 (1988)

<sup>5</sup> Other provisions in the 1934 Act similarly employ the "directly or indirectly" language in contexts in which the phrase cannot meaningfully be interpreted as referring to aiding and abetting. See, e.g., §§ 7(f)(2)(C) (directly or indirectly owning stock); 16(a) (same); 9(a)(5) (directly or indirectly receiving consideration); 9(b)(2),(3) (directly or indirectly owning an interest in certain securities); 11(d) (directly or indirectly extending credit to a customer); 12(b)(1),(2) (directly or indirectly controlling another entity); 13(b)(1) (same); 21A(a)(3) (same); 13(d)(1) (directly or indirectly acquiring ownership).

(holding that § 12(1) of the 1933 Act does not impose liability for "participation" in transactions in violation of that provision, *id.* at 650, but reserving judgment on the issue of whether the provision gives rise to liability for aiding and abetting, *id.* at 648 n.24).

In statutes written both before and after 1934, Congress has proved able to provide expressly for liability against aiders and abettors of securities violations in criminal and SEC enforcement actions. E.g., 15 U.S.C. § 78o(b)(4)(E) (1988); 18 U.S.C. § 2(a) (1988). Respondents' and the Commission's strained efforts to show that the language of § 10(b) and related provisions encompasses aiding and abetting liability cannot overcome the simple fact that Congress did not include explicit aiding and abetting language in these provisions, where elsewhere it has.

## **B. An Analysis Of Congressional Intent Does Not Support Recognition Of An Implied Private Right Of Action For Aiding And Abetting.**

### **1. Aiding And Abetting Is Not Merely An "Aspect" Of The Implied Private Right Of Action Under Section 10(b) Previously Recognized By This Court.**

The Commission argues that a private right against aiders and abettors is akin to the right to contribution, which it asserts the Court in *Musick* treated as simply an "aspect" of the existing 10b-5 private right of action. (SEC Br. 6; see also Resp. Br. 11-12.) However, in dealing with rights to contribution, the Court needed only be concerned with how to allocate existing liability:

The parties against whom contribution is sought are, by definition, persons or entities alleged to have violated existing securities laws and who share joint liability for that wrong under a remedial scheme established by the federal courts. Even though we are being asked to recognize a cause of action that supports a suit against these parties, the



duty is but the duty to contribute for having committed a wrong that courts have already deemed actionable under federal law.

113 S. Ct. at 2088. In contrast, this Court has not previously deemed aiding and abetting actionable, but has expressly reserved the question. Since the existence of private liability for aiding and abetting under § 10(b) has not been established, the central question of whether Congress would have assessed liability against those who substantially assist, but do not commit, the primary wrong remains to be answered.<sup>6</sup>

Furthermore, the Commission's characterization of this case as a "rounding out" of the existing 10b-5 remedies (SEC Br. 7), even if accepted, does not alter the requisite congressional intent analysis. The Commission draws the phrase "rounding out" from the *Virginia Bankshares* opinion, and also cites *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), for the concept of "flesh[ing] out" an existing right of action. Yet both of these decisions emphasize that the Court's primary concern in defining implied rights of action under the securities laws is with congressional intent. *Virginia Bankshares*, 111 S. Ct. at 2763-64 (citing *Cort v. Ash* and *Touche Ross*); *Blue Chip Stamps*, 421 U.S. at 736; 421 U.S. at 756 (Powell, J., concurring). This central inquiry simply cannot be circumvented.

## 2. Congress Did Not Incorporate Private Aiding And Abetting Rights Into Section 10(b) In 1934.

Respondents contend that the 1934 Congress must have contemplated aiding and abetting as included within § 10(b),

<sup>6</sup> *Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353 (1982), likewise provides no support for the Commission's position. The Court there simply held that privity of dealing was not required to impose liability under the Commodity Exchange Act. *Id.* at 394. The relevant defendants were themselves alleged to have engaged in manipulative conduct, unlike aiders and abettors, and were subject to liability as primary violators. *Id.* at 392 n.95, 394 & n.101. *American Society of Mechanical Engineers, Inc. v. Hydrolevel Corp.*, 456 U.S. 556 (1982), is even further removed from the present case, since there the Court was dealing with an express right of action under the Sherman Act and simply applied basic agency principles to that express right. *Id.* at 570.

because as of 1934 aiding and abetting could give rise to criminal liability and had been applied to common law fraud and deceit actions. (Resp. Br. 13-17.) However, inclusion of express aiding and abetting liability in the federal criminal code militates against a finding that Congress intended aiding and abetting to be included within the civil provisions of the 1934 Act. Congress had elsewhere used aiding and abetting language explicitly prior to 1934, and could have done so in § 10(b) had it desired.<sup>7</sup> See *Blue Chip Stamps*, 421 U.S. at 734. Similarly, Congress' explicit creation of secondary liability in private actions against control persons evidences that Congress did not simultaneously contemplate secondary liability within § 10(b).<sup>8</sup>

Respondents' and the Commission's reliance on the state of certain common law actions in 1934 (Resp. Br. 15-17; SEC Br. 10-11) is misplaced. This Court has acknowledged that it was not the design of the 1934 Congress to create the private right of action later implied under § 10(b). *Lampf*, 111 S.Ct. at 2780. It is far beyond the realm of reality to contend that Congress was aware of the state of the common law in 1934 and intended to incorporate general common law standards

<sup>7</sup> It is certainly not "anomalous," as Respondents assert without support (Resp. Br. 14), for a provision in the securities laws to give rise to criminal liability but not private civil liability. Violation of any provision in the 1934 Act, with only one exception, can give rise to criminal liability pursuant to § 32 of the Act, 15 U.S.C. § 78ff (1988). No court or commentator has seriously suggested that every provision in the 1934 Act should therefore give rise to a private right of action. Indeed, under Respondents' analysis, the Court's decision in *Touche Ross* would have to be considered anomalous, since it held that there is no implied private right of action under § 17(a) of the 1934 Act, which imposes certain reporting requirements violation of which may be a criminal offense under § 32.

<sup>8</sup> Respondents and the Commission argue that § 20, the control person provision, did not preempt any other possible form of secondary liability, citing various cases holding that § 20 did not eliminate potential claims under a theory of respondeat superior. (Resp. Br. 19-20; SEC Br. 9-10.) This is beside the point. Whether or not § 20 should be taken as the exclusive basis for secondary liability under the 1934 Act, the provision reflects a clear congressional intent as of 1934 to impose secondary liability in private actions against employers of primary violators. Congress could have expressed a similar intention to create liability against aiders and abettors, but did not.

within the § 10(b) private right of action which it never contemplated.

In addition, this Court has left no question that private rights under the securities laws are not to be implied based upon principles of tort law. As Central Bank observed in its opening brief (Pet. Br. 30-31), the Supreme Court has stated unequivocally that an "argument in favor of implication of a private right of action based on tort principles . . . is entirely misplaced." *Touche Ross*, 442 U.S. at 568. Remarkably, neither Respondents nor the Commission nor Respondents' other amici respond to this controlling language in *Touche Ross*, or even cite *Touche Ross* at any point in any of their briefs.<sup>9</sup> Securities laws and business torts constitute distinct areas of the law. The availability of aiding and abetting liability in any common law action is simply not relevant to the present inquiry, and certainly does not serve to show that the 1934 Congress intended to include aiding and abetting as part of the private rights of action subsequently implied under § 10(b).

### 3. Congress Has Not Created A Private Right Of Action For Aiding And Abetting Under Section 10(b) Since 1934.

The Commission heavily emphasizes that Congress has not disturbed the lower courts' interpretation of § 10(b) as including a private right of action against aiders and abettors.

<sup>9</sup> Respondents and the Commission seem to suggest that common law principles may at least be used as a floor below which the protections of the 1934 Act cannot fall. (Resp. Br. 17; SEC Br. 21 n.21.) Thus, common law should not be used to reduce the scope of the securities laws, although common law principles could be used to expand their scope. While this theory could be consistent with *Herman & MacLean v. Huddleston*, 459 U.S. 375, 388-89 (1983), it does nothing to explain *Touche Ross*, 442 U.S. at 568 (refusing to imply a private right of action under § 17(a) of the 1934 Act based on principles of tort law), or *Blue Chip Stamps*, 421 U.S. at 744-45 (refusing to expand § 10(b) rights of action to plaintiffs who were not actual purchasers or sellers, even though the related torts of misrepresentation and deceit did not impose a strict purchaser/seller requirement). Cf. *Lampf*, 111 S.Ct. 2773 (imposing statute of limitations on implied § 10(b) rights more restrictive than statutes of limitations applicable under common law).

(SEC Br. 11-16.) A review of the actions Congress has and has not taken over time demonstrates that, far from embracing an implied private aiding and abetting right, Congress has chosen to incorporate aiding and abetting liability only in disciplinary and criminal contexts.

Between 1957 and 1960, Congress failed to add proposed language to § 20 of the 1934 Act which would have created a private right of action against aiders and abettors of securities violations. See H.R. 2480, 86th Cong., 1st Sess. §§ 21, 22 (1959); S. 1179, 86th Cong., 1st Sess. §§ 21, 22 (1959). The Commission observes that this legislation was not intended to address private rights of action, and that the Senate passed a version of the legislation which would have added aiding and abetting to the Commission's rights to seek injunctive relief. (SEC Br. 15.) Respondents similarly argue that the legislation was actually intended to strengthen the Commission's injunctive powers, and notes that in later years aiding and abetting language was added to relevant SEC enforcement provisions. (Resp. Br. 21 n.14.) Each of these facts supports the inference that it has at all times been the intention of Congress to include aiding and abetting within the reach of the Commission's disciplinary powers, not within private civil actions. When aiding and abetting language was written broadly enough to encompass private actions, the securities industry objected to the proposal and it was never passed. See *SEC Legislation: Hearings before a Subcommittee of the Committee on Banking and Currency, United States Senate, 86th Cong., 1st Sess., on S. 1178, S. 1179, S. 1180, S. 1181, and S. 1182*, 288, 370 (1959) (Commission memorandum noting industry fears that provision would create private aiding and abetting right and suggesting that it be amended to "[m]ake it clear that no civil liability is intended").

In contrast, in 1964 when the aiding and abetting language was limited to SEC enforcement remedies, the proposal succeeded. (See Pet. Br. 22-23.) Respondents argue that Congress did not need to provide private aiding and abetting rights at the same time it created powers against aiders and abettors in favor of the Commission, since it had reason to



think that the judiciary would develop adequate implied private rights. (Resp. Br. 22 n.14.) However, by 1964, courts had long recognized an implied right of action against aiders and abettors of securities violations in favor of the SEC. *See, e.g., SEC v. Timetrust, Inc.*, 28 F. Supp. 34, 43 (N.D. Cal. 1939). At that time the landmark case first recognizing an implied private right of action against aiders and abettors, *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970), had not yet been decided.<sup>10</sup> If the 1964 Congress had wished both private parties and the Commission to have rights against aiders and abettors, it is the Commission action, not the private action, which it might have felt safe leaving to the courts. Its creation of aiding and abetting liability only in favor of the Commission belies any inference that it also intended analogous private rights.

Respondents and the Commission stress that in 1975, when it made significant changes to the 1934 Act, Congress did not disavow the implied private right against aiders and abettors which some lower courts had by then recognized. While the Court has previously considered congressional inaction in 1975 to provide some evidence of intent, *Herman & MacLean*, 459 U.S. at 384-86, it is certainly not compelling evidence. For instance, in its *Lampf* decision the Court reversed the lower courts' traditional practice of employing an analogous state statute of limitations, even though Congress had not chosen to disavow the practice in 1975. *See* 111 S.Ct. at 2784 (Stevens, J., dissenting) (noting long history of rule applied by lower courts). The 1975 revisions to the 1934 Act provide particularly weak evidence of congressional intent here, for several reasons. First, congressional inaction

<sup>10</sup> Respondents cite to one prior case, *Pettit v. American Stock Exchange*, 217 F. Supp. 21, 28 (S.D.N.Y. 1963), however this case noted the availability of aider and abettor liability in a single sentence without analysis. The *Brennan* decision has generally been regarded as the case which "first recognized [aiding and abetting liability] in a private civil action under the federal securities laws." (Brief Amicus Curiae of the Association of the Bar of the City of New York in Support of Respondents, p. 12.)

should not be viewed as an endorsement of a statutory interpretation which it has previously declined to codify within the statute. (See Pet. Br. 22 n.15.) Second, in 1975 Congress did add further SEC disciplinary powers reaching aiders and abettors, for which Respondents and the Commission provide no explanation. Third, the private right of action Respondents advocate was hardly settled by 1975. To the contrary, in 1975 the Court rendered its decisions in *Blue Chip Stamps* and *Cort v. Ash*, placing the further expansion of implied private rights under the securities laws in grave doubt.

Subsequent legislative history from 1977 cited by the Commission (SEC Br. 13-14) makes no reference to secondary liability of any kind. Nor can aiding and abetting be considered within the scope of the private cause of action which Congress noted courts had recognized, since by 1977 this Court had expressly reserved judgment as to any such implied right. *Ernst & Ernst*, 425 U.S. at 191 n.7.

The Insider Trading Sanctions Act of 1984, cited by the Commission (SEC Br. 14), provides no support for the Commission's position. By that point the *Touche Ross* decision had been rendered, making it even more dubious that Congress could have considered the existing judicial application of aiding and abetting to include an implied private right of action. Furthermore, that act again created rights only in favor of the Commission against aiders and abettors. The discussion leading up to the statement quoted by the Commission concerning the Committee's endorsement of aiding and abetting is devoted exclusively to SEC enforcement of the securities laws. H.R. Rep. No. 355, 98th Cong., 2d Sess. 9-10 (1983), *reprinted in* 1984 U.S.C.C.A.N. 2274, 2282-83. The subsequent paragraph goes on to list the many remedies available against aiders and abettors of the securities laws, but implied private rights of action are conspicuously absent from the list. *Id.* at 10. Finally, the act's secondary liability provisions were sharply limited, and the Commission itself explained that the existing SEC remedies against aiders and abettors under § 15 of the 1934 Act were sufficient to provide ample deterrence against aiding and abetting violations. *Id.* at 28. This hardly constitutes a ringing endorsement of broad private rights of



action against aiders and abettors, but instead reinforces the view that Congress has consistently determined SEC disciplinary powers to provide adequate means of dealing with aiders and abettors. In 1986 SEC remedies against aiders and abettors were again added to the 1934 Act, further supporting this interpretation.

The language of the Insider Trading and Securities Fraud Enforcement Act of 1988 quoted by Respondents and the Commission (Resp. Br. 25-26; SEC Br. 14-15), has already been interpreted by this Court as "an acknowledgement of the 10b-5 action without any further expression of legislative intent to define it." *Musick*, 113 S.Ct. at 2089. The Commission would have the Court now read more into the statement than is warranted by its context. The statement is contained in a footnote which reflects the Committee's intention that its limitation of respondeat superior liability in the insider trading context should "not affect the applicability of the respondeat superior theory in Commission actions or under the federal securities laws generally." H.R. Rep. No. 910, 100th Cong., 2d Sess. 27 n.23 (1988), reprinted in 1988 U.S.C.C.A.N. 6043, 6064 n.23. The note then adds, "Similarly, it does not affect the availability of any other theories of liability, such as aiding and abetting or the failure to supervise, in appropriate circumstances." *Id.* The passage may be read simply as a reference to the Commission's express rights of action for aiding and abetting. At best, the footnote is ambiguous. The Court "should not condone the implication of any private action from a federal statute absent the most compelling evidence that Congress in fact intended such an action to exist." *Cannon v. University of Chicago*, 441 U.S. 677, 749 (1979) (Powell, J., dissenting). This footnote's single relevant sentence hardly qualifies as "compelling evidence."

Finally, SEC disciplinary powers against aiders and abettors of certain securities violations were once again added in 1990. The persistent congressional pattern of incorporating aiding and abetting into the securities laws only in the criminal and disciplinary contexts continues to this day. Congress has repeatedly had the opportunity to create express rights

against aiders and abettors in favor of both the Commission and private parties, and it has chosen to grant only the former.

### C. Policy Considerations Do Not Warrant Creation Of An Implied Private Right Of Action For Aiding And Abetting.

The Commission argues that policy considerations support implication of an implied private right of action against aiders and abettors of violations of § 10(b). (SEC Br. 16-17.) The Commission again relies on the outdated philosophy of *J.I. Case Co. v. Borak*, and on the lower courts' acceptance of an aiding and abetting theory based on tort principles which this Court has since invalidated as a basis for implying new rights under the 1934 Act.<sup>11</sup> The Commission's policy arguments cannot provide a basis for an implied private right of action against aiders and abettors, and even if this issue were to be decided on policy considerations, significant concerns weigh against recognition of a private aiding and abetting right.

Similar policy considerations were presented by the parties in *Musick* and were rejected flatly by the Court, which held that its "task is not to assess the relative merits of the competing rules." 113 S.Ct. at 2089. In *Touche Ross*, the Court noted, "The ultimate question is one of congressional intent, not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law." 442 U.S. at 578. The Commission's policy views, even if accepted by the Court, cannot justify judicial creation of an implied private right of action against aiders and abettors.

<sup>11</sup> Respondents also rely heavily on the lower courts' acceptance of an aiding and abetting cause of action to establish that such an action does not interfere with the effective operation of the securities laws. (Resp. Br. 26-29.) This reverses this Court's sequence of analysis followed in the recent past, under which the primary inquiry is one of congressional intent. Only after a basis is found for concluding that the 1934 Congress would have wished a right to be included does the Court consider whether recognition of the right might interfere with operation of the securities laws. *Musick*, 113 S. Ct. at 2089-92.

Furthermore, to the extent that policy implications are considered, the Court has gone beyond the Commission's emphasis on ensuring maximum enforcement of the securities laws. In *Blue Chip Stamps* and *Virginia Bankshares*, the Court was at least as concerned with the danger of speculative securities claims. 421 U.S. at 738-749; 111 S. Ct. at 2764-65. As in *Virginia Bankshares*, the claims here are made possible by the lack of any rigorous causation requirement. Under Respondents' theory, Central Bank's substantial assistance of the alleged fraud is little more than "but for" causation: But for Central Bank's agreement to delay a new appraisal, the insufficiency of the security for the bonds would have been exposed and the bonds would not have been issued and sold to Respondents. Proof of such inferences as to what might have been would require the same type of guesswork and unreliable evidence that the Court disapproved in *Virginia Bankshares*, 111 S.Ct. at 2765, and would open the doors of the federal courts to an entire class of unduly speculative claims.<sup>12</sup>

## II. LIABILITY FOR AIDING AND ABETTING A VIOLATION OF SECTION 10(b) AND RULE 10b-5 SHOULD NOT BE IMPOSED BASED ONLY ON RECKLESSNESS IN THE ABSENCE OF A PRE-EXISTING DUTY TO DISCLOSE OR TO ACT.

The court below held that Central Bank could be liable for aiding and abetting based upon mere recklessness because

<sup>12</sup> The Commission's response to the threat of speculative or vexatious claims is to call for unspecified safeguards to reduce such claims and, if unsuccessful, to allow Congress to reduce or reject the implied aiding and abetting private right. (SEC Br. 16-17.) The Commission again would turn this Court's analysis on its head. Given the complete lack of congressional intent to impose aiding and abetting liability in § 10(b) or analogous sections embodying express private rights and its countervailing intent to confine aiding and abetting liability to criminal and disciplinary actions, it should be left to Congress to determine whether it wishes to create aider and abettor liability in private § 10(b) cases and what the appropriate limitations upon such liability should be.

Central Bank's conduct included an affirmative act. Respondents and the Commission defend the court's outcome because in their view recklessness should always be sufficient scienter for aiding and abetting. Both of these approaches are flawed. They are both far afield of the requirement of deceptive or manipulative conduct by the defendant and both would permit liability in cases, such as this one, where the defendant owed no pre-existing duty to the plaintiffs and committed no affirmative misrepresentation.

### A. Aiding And Abetting Liability May Not Appropriately Be Premised On Recklessness In All Cases.

In the context of aiding and abetting liability, as opposed to primary liability, under § 10(b), the various courts of appeals uniformly have permitted liability based on recklessness only where some condition is met to render recklessness an appropriate standard of scienter. The majority of circuits require a pre-existing duty to disclose or to act owed by the defendant before recklessness will be considered sufficient. (Pet. Br. 39-40.) The Seventh Circuit requires something more, that the defendant meet all requirements for primary liability except that he need not have actually purchased or sold securities. *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495 (7th Cir. 1986). The Ninth Circuit requires some affirmative misrepresentation by the defendant before a recklessness standard will be imposed. *Levine v. Diamantheset, Inc.*, 950 F.2d 1478, 1484 & n.4 (9th Cir. 1991). Surprisingly, Respondents, the Commission, and Respondents' other amici for the most part abandon any such conditional scienter test for aiders and abettors. Their extreme position, by equating the culpability of primary violators with that of aiders and abettors in *all* instances, ignores the mandate of *Ernst & Ernst*, which requires a finding of deceptive conduct by the defendant, and would lead to unwarranted results.

The Commission notes that every court of appeals has accepted recklessness as an adequate scienter standard for



primary liability under § 10(b), an issue not before the Court today, but then goes on to argue that the scienter test for aiding and abetting should be the same as that for primary liability.<sup>13</sup> (SEC Br. 22-24.) Each of the lower courts, whose decisions the Commission argues should be given "considerable weight" for purposes of implying a private aiding and abetting right (*id.* at 17), requires some additional condition before it will apply the recklessness standard used generally in primary liability cases to the context of aiding and abetting. (See summary of lower courts' approaches at Pet. Br. 38-45.) As will be seen, without regard to what might be an appropriate standard of scienter for primary liability, recklessness does not adequately meet the requirements of the statutory language as interpreted in *Ernst & Ernst*, in cases such as this where the defendant owed no duty to disclose or to act and made no misrepresentations to the plaintiffs.

Respondents argue that a recklessness standard<sup>14</sup> is in accordance with the intent of the 1934 Congress, because a recklessness standard was often used in common law actions in 1934 (Resp. Br. 33-35, 39-42) and because express liability provisions of the 1934 Act require no more than recklessness

<sup>13</sup> In support of using the same standard in both contexts, the Commission stresses that the recklessness standard comports with the broad remedial purposes of the securities laws (SEC Br. 24), again failing to apprehend that the issue today is not one of policy, but of statutory interpretation.

<sup>14</sup> Respondents consistently contrast the general recklessness standard they advance with the "high conscious intent" standard Central Bank supposedly endorsed. (See, e.g., Resp. Br. 29 ("Petitioner contends that the Tenth Circuit should have employed a 'high conscious intent' standard.")) Central Bank made no such contention. Central Bank argued in its opening brief simply that recklessness is not sufficient scienter for aiding and abetting in the absence of a duty to disclose or act. While the Court need not reach the issue, under the rule applied by most of the lower courts, a standard of actual knowledge is used in the absence of such a duty. This standard rises to conscious intent where the defendant's substantial assistance of the fraud is accomplished by inaction. See Joel S. Feldman, *The Breakdown of Securities Fraud Aiding and Abetting Liability: Can a Uniform Standard Be Resurrected?*, 19 Sec. Reg. L.J. 45, 53-57 (1991).

(Resp. Br. 36-39).<sup>15</sup> Respondents' reliance upon express liability provisions within the 1934 Act is the reverse of the approach this Court took with respect to such provisions in *Ernst & Ernst*. In dealing with the issue of whether negligent conduct could suffice under § 10(b), the Court pointed out that Congress had created express remedies which reached certain negligent conduct but imposed procedural restrictions not found in § 10(b). 425 U.S. at 208-09. Thus the Court concluded that § 10(b), which has no such restrictions, could not be extended, consistent with the intent of Congress, to actions premised on negligent conduct. Following this analysis, Respondents' contention that express liability provisions of the 1934 Act require no more than reckless conduct leads to the conclusion that Congress likely would have intended a greater scienter standard for the § 10(b) "catchall" remedy.

Respondents' use of common law principles to demonstrate congressional intent in 1934 or the proper scope of § 10(b) liability is also flawed.<sup>16</sup> Their assertion that Congress must have intended the scienter standard in implied private actions under § 10(b) to match that of certain common law actions existing in 1934 goes even beyond the "pretense" the Court disavowed in *Lampf*, 111 S.Ct. at 2780. Congress did not contemplate any private remedy, let alone a remedy for aiding and abetting, when it created § 10(b), nor should the terms of § 10(b) necessarily be construed in accordance with common law principles. See discussion, *supra*, at 7-8. Furthermore, Respondents' and the Commission's reliance on the principle at common law that reckless misrepresentations are actionable, see, e.g., *Cooper v. Schlesinger*, 111 U.S. 148, 155 (1884) ("a statement recklessly made, without knowledge

<sup>15</sup> Respondents also note that the Court found in *Ernst & Ernst* that § 10(b) liability may not be imposed where the defendant acted in good faith. (Resp. Br. 35-36.) Obviously, this rule would not be violated by a finding that scienter greater than mere recklessness is required to impose aiding and abetting liability.

<sup>16</sup> *Ernst & Ernst* reserved the question of whether recklessness could meet the § 10(b) scienter requirement and merely noted that under certain areas of the law recklessness is treated as intentional conduct. 425 U.S. at 193 n.12. This was not an endorsement of applying general common law concepts to § 10(b).



of its truth, [is] a false statement knowingly made"), is misplaced. In the context of affirmative misrepresentations made in reckless disregard of the truth, recklessness might fairly be said to demonstrate an intent to mislead. However, Central Bank is accused of an entirely different brand of recklessness far removed from such forms of affirmative deception. The false and misleading statements alleged in this case were made in disclosure documents which were not prepared by Central Bank. Central Bank is not alleged to have made any false statements to investors, recklessly or otherwise. Instead, the bank is accused of recklessly choosing to delay an independent appraisal which allegedly allowed the fraud to occur.

The facts of this case illustrate the extreme results which are possible under a scienter standard of recklessness applied in all instances. Under such a rule a defendant may be held liable for aiding and abetting a violation of § 10(b) where, as here, he was under no duty to disclose or to act and where he made no affirmative misrepresentations. None of the courts of appeals have been willing to follow such an extreme approach. More importantly, this is not the type of manipulative or deceptive conduct contemplated by the Court's decision in *Ernst & Ernst* or the language of § 10(b).<sup>17</sup>

**B. Central Bank Should Not Be Subject To Liability Based On Recklessness Merely Because It Committed Some "Affirmative Act," Where It Owed No Pre-Existing Duty To Disclose Or To Act.**

Respondents pay lip service to the basis of the lower court's decision by arguing that the question of Central Bank's duty to disclose or act is irrelevant, "particularly" where it committed an affirmative act. (Resp. Br. 42-46.)

<sup>17</sup> In addition to the statutory language, Respondents improperly rely on the language of Rule 10b-5. Respondents themselves note that the Rule would permit § 10(b) liability based on unintentional conduct, which is obviously not proper. This Court has held that the wording of the Rule is not an appropriate determinant of permissible standards for § 10(b) liability. *Ernst & Ernst*, 425 U.S. at 214 ("despite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b)").

However, Central Bank's conduct, which violated no pre-existing duties, is not transformed into the type of manipulative or deceptive conduct contemplated by *Ernst & Ernst* simply because the court of appeals chose to characterize its conduct as an "affirmative act." Respondents argue that Congress did not contemplate a sliding scale scienter requirement under which liability based on recklessness would be allowed only in the face of a pre-existing duty to disclose or to act, but Respondents cannot avoid the fact that Congress *did* contemplate that § 10(b) would apply only to those guilty of manipulative or deceptive conduct. If recklessness ever rises to this level, it can do so only where the defendant's conduct is in the nature of manipulation or deception because by its reckless acts the defendant disregarded a pre-existing duty to the plaintiff. Where there was no pre-existing duty creating the expectation that a defendant would act to protect the plaintiff's interests, a defendant's failure to uncover and stop the fraud of another is not a form of manipulation or deception.<sup>18</sup>

In the absence of a pre-existing duty, the defendant's conduct is not rendered manipulative or deceptive simply by the talismanic effect of any affirmative action. Respondents attempt to create this result by bootstrapping a duty from the fact that Central Bank took some affirmative action. (Resp. Br. 44-45.) This does not give rise to any duty which might render Central Bank's conduct manipulative or deceptive. Central Bank did not itself commit any affirmative misrepresentation. *Compare Levine*, 950 F.2d at 1484 n.4. Central Bank is not accused of taking an action which made Respondents' situation worse. *Compare W. Prosser, The Law of Torts* § 339 (3d ed. 1964). Rather, Central Bank is accused of agreeing to delay taking an action, obtaining an independent

<sup>18</sup> This is directly analogous to the conclusion that a failure to speak may become actionable in light of a pre-existing duty to disclose. *Chiarella v. United States*, 445 U.S. 222 (1980). The Commission's attempts to distinguish the two situations (SEC Br. 24 n. 27), misses the mark. While the primary violators in this case may have made affirmative misrepresentations, Central Bank did not. Without some pre-existing duty governing its conduct, Central Bank's failure to discover the misrepresentations, even if reckless, is not a violation of § 10(b).

appraisal, which might have made Respondents' situation better by allegedly preventing the bond issue from going forward.<sup>19</sup> This is not conduct which may fairly be described as manipulative or deceptive. If such tenuous "affirmative actions" are accepted as the basis for aiding and abetting liability based on recklessness, then banks, accountants, lawyers, and other parties to securities transactions will have little protection against investors who might second guess their conduct, claiming that their actions, though fully in accord with their state law duties, nonetheless allowed the fraud to occur. The Tenth Circuit's opinion, which subjected Central Bank to potential liability based on just this type of speculative reasoning, should be reversed.

Respectfully submitted this 13th day of October, 1993.

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<sup>19</sup> Again, Central Bank's conduct as easily could be described as a failure to insist upon an independent appraisal. Agreeing to delay some event is not the type of "action" which might in other circumstances generate "bystander" liability (SEC Br. 26 n.30), and such insubstantial "affirmative acts" provide no logical or workable basis for subjecting a defendant to liability for recklessly aiding and abetting a securities fraud. To the extent the Commission follows the Tenth Circuit's "affirmative action" standard (*see* SEC Br. 19 n. 18), it has forfeited any claim to a "flexible, predictable approach." (*Id.* at 24-30.)

(7)  
No. 92-854

Supreme Court Case  
FILED  
JUL 30 1993

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IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1993

CENTRAL BANK OF DENVER, N.A.,  
*Petitioner,*  
v.  
FIRST INTERSTATE BANK OF DENVER, N.A.,  
AND JACK K. NABER,  
*Respondents.*

On Writ Of Certiorari To The  
United States Court Of Appeals  
For The Tenth Circuit

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**QUESTIONS PRESENTED**

*Amicus curiae* will address the following questions:

1. Whether there is an implied private right of action for aiding and abetting violations of § 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5.
2. Whether recklessness is an appropriate standard upon which to predicate liability for aiding and abetting violations of § 10(b) and Rule 10b-5.

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IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1993

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No. 92-854

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CENTRAL BANK OF DENVER, N.A.,  
*Petitioner,*

v.

FIRST INTERSTATE BANK OF DENVER, N.A.,  
AND JACK K. NABER,  
*Respondents.*

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On Writ Of Certiorari To The  
United States Court Of Appeals  
For The Tenth Circuit

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BRIEF *AMICUS CURIAE* OF THE SECURITIES  
INDUSTRY ASSOCIATION  
IN SUPPORT OF PETITIONER

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The Securities Industry Association ("SIA") files this brief *amicus curiae* in support of petitioner. The purpose of this brief is twofold: First, to demonstrate that the Congress that enacted § 10(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78j(b), did not create and would not have intended to create a private right of action for "aiding and abetting" violations of that statute; and second, to explain why, even if there were an implied § 10(b) private right of action for aiding and abetting, "recklessness" would be an improper standard upon which



to predicate liability because it would contradict the express language of § 10(b), conflict with the historical concept of aiding and abetting as a willful act, and inject intolerable confusion and uncertainty into the enforcement of the federal securities laws, thereby undermining the legislative goal of maintaining stable and efficient securities markets.

### INTEREST OF AMICUS CURIAE

The Securities Industry Association is the principal trade association of the securities industry. Its members include approximately 700 securities firms in the United States and Canada. Its membership is responsible for over ninety percent of the securities business conducted in this country. SIA's members serve securities investors of every size and type and perform the complete spectrum of professional securities activities, including retail and institutional brokerage, over-the-counter market-making, underwriting and other investment banking activities, money management, and investment advisory services.

SIA is recognized as a spokesman for the securities industry in general and the broker-dealer community in particular. A major function of SIA is to address legislative and regulatory matters affecting the securities industry on the national and state levels.

SIA has a substantial interest in this Court's determination of the § 10(b) aiding and abetting issues presented by this case. Securities professionals are joined routinely in private § 10(b) actions solely on the basis of generalized allegations of "recklessly" aiding and abetting the violations of others and in the absence of any fiduciary or other duty owed to plaintiffs. For example, such claims are sometimes asserted against broker-dealers who as intermediaries perform vital but largely ministerial and remote functions in connection with securities transactions, such as clearing transactions between third parties, executing

non-discretionary orders received from third parties or serving as the custodian of funds of others. Accordingly, SIA is particularly well-suited to assist the Court in addressing the important issues presented by this case.<sup>1</sup>

### STATUTE AND RULE INVOLVED

1. Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b):

#### § 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange —

\* \* \*

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

2. Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5:

#### § 240.10b-5. Employment of manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange,

<sup>1</sup> Letters reflecting written consent of the parties to the filing of this brief have been filed with the Clerk of the Court.

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

#### SUMMARY OF ARGUMENT

There is no basis for recognizing an implied private remedy for aiding and abetting violations of § 10(b). Although this Court in 1971 acquiesced in the lower courts' recognition of an implied private right of action for primary violations of § 10(b), and has since recognized limited judicial authority to "flesh out" the contours of that right, that does not provide authority to create a new private right of action for § 10(b) aiding and abetting. Such a remedy would be a separate and independent cause of action that establishes liability for a new class of defendants not already subject to suit. It necessarily would have elements that are different from the implied private remedy for primary § 10(b) violations. Thus, to impose § 10(b) aiding and abetting liability, the Court must do more than simply elaborate on the contours of the already existent § 10(b) implied private remedy: it must create an entirely new cause of action. But the Court has recently made clear that it will not recognize any new implied private right of action in the absence of clear evidence that Congress intended to create such a remedy. And there is nothing in the text or history of § 10(b) even remotely suggesting that Congress intended to create a private cause of action for § 10(b) aiding and abetting. Indeed, it was

not even Congress' design to create a private remedy for *primary* violations of § 10(b).

The express private remedial provisions of the 1934 Act and the Securities Act of 1933 ("1933 Act")—enacted contemporaneously with § 10(b)—do not impose aiding and abetting liability. Efforts to amend the express private rights of action to include aiding and abetting as a basis for a private damages action have been uniformly rejected. Instead, Congress has established and maintained a limited express remedial scheme to impose liability on certain collateral participants in securities transactions. Judicial creation of a new implied § 10(b) private remedy for aiding and abetting would directly undermine the policy choices of Congress regarding the type of secondary liability appropriate under the Nation's securities laws. This Court should not raise up yet another implied right of action under § 10(b) that has no basis in and would frustrate congressional intent.

Even if an implied private right of action for § 10(b) aiding and abetting could be discerned from congressional intent, it would be impermissible to permit recovery under that cause of action for recklessness. The operative language of § 10(b)—"manipulative or deceptive device or contrivance"—strongly suggests that § 10(b) prohibits only misconduct that is committed with actual knowledge of the fraud, not simply reckless behavior. Further, the recklessness standard is inconsistent with the criminal law concept of aiding and abetting, which inherently involves willful conduct and is the asserted doctrinal basis for imposing aiding and abetting liability under § 10(b). And the recklessness standard, in practice, has proven to be highly malleable and uncertain, often confused with the negligence standard that this Court has rejected as a basis for § 10(b) liability.

A recklessness standard is particularly inappropriate where, as in this case, the defendant had no fiduciary duty



of disclosure to the plaintiff and made no affirmative misrepresentations. Application of a recklessness standard would directly contradict this Court's decisions holding that § 10(b) liability, even against primary violators, may not be imposed based upon a defendant's silence in the absence of a duty of disclosure. Recklessness as a standard would subject securities professionals to costly and consuming § 10(b) litigation based not upon their actual awareness of the alleged fraud, or even upon their breach of a fiduciary duty, but rather simply upon their routine involvement in securities transactions. Such a result is highly unfair and runs directly counter to the goal of the Congress that enacted § 10(b) to devise a remedial scheme that would protect investors while minimizing unnecessary and intrusive interference with the operation of the Nation's securities markets.

### ARGUMENT

#### A. The Congress That Enacted § 10(b) Did Not Create And Would Not Have Intended To Create A Private Right Of Action For Aiding And Abetting Violations Of § 10(b).

Neither the text of § 10(b) itself, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976), nor the "contemporaneously enacted express remedial provisions," *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773, 2780 (1991), provide any evidence that the 73rd Congress—the Congress that enacted § 10(b)—intended to afford a right to private plaintiffs to sue participants in securities transactions for aiding and abetting a § 10(b) violation. Accordingly, there is no such private right of action. *Texas Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630 (1981); *Northwest Airlines, Inc. v. Transport Workers Union*, 451 U.S. 77 (1981); *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979).

#### 1. Aiding And Abetting Is An Independent Cause Of Action.

Although this Court has recognized "judicial authority to shape, within limits," the implied private right of action for primary violations of § 10(b) that it has already accepted, see *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 113 S. Ct. 2085, 2089 (1993), that authority provides no basis for creating a private right of action for "aiding and abetting" a violation of § 10(b). That is because a § 10(b) aiding and abetting claim is "a separate or independent cause of action." *Id.* at 2088. Indeed, if it were not, there would have been no reason for the lower federal courts to have invented it. The first case to recognize a § 10(b) implied private right of action for aiding and abetting was brought against the alleged aider and abettor only, without even joining the primary violator as a defendant, who was unavailable and judgment-proof.<sup>2</sup> Ever since that decision in 1966, the courts have treated aiding and abetting private claims asserted pursuant to § 10(b) as a stand-alone species of securities fraud, complete with its own elaborate and complicated jurisprudence.

The implied private right of action for a primary violation of § 10(b), on the one hand, and the § 10(b) aiding and abetting right of action, on the other, necessarily consist of different elements and extend to different classes of defendants. For example, the private right of action for a primary § 10(b) violation generally is understood to include the following elements: (1) use of an instrumentality of interstate commerce; (2) a material misrepresentation

<sup>2</sup> See *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673, 676 (N.D. Ind. 1966) (rejecting the argument that the 1934 Act "exclude[s] persons who do no more than aid and abet a violation of Section 10(b) and Rule 10b-5"); see also *Brennan v. Midwestern United Life Ins. Co.*, 286 F. Supp. 702 (N.D. Ind. 1968) (opinion on merits discussing bankruptcy and death of primary violator), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).



or omission; (3) an intent to deceive, manipulate or defraud (scienter); (4) reliance by the plaintiff on the defendant's misrepresentation; (5) causation; and (6) damages flowing from the defendant's misconduct. *See, e.g., Weitzman v. Stein*, 436 F. Supp. 895, 902-04 (S.D.N.Y. 1977). Where the plaintiff's § 10(b) claim is predicated on an allegation that the defendant failed to disclose material information, the plaintiff must additionally prove that the defendant had assumed a duty to disclose. *See Chiarella v. United States*, 445 U.S. 222 (1980).

By contrast, the elements of the § 10(b) aiding and abetting right of action that have been fashioned by the lower courts are ordinarily stated in terms similar to those articulated by the Tenth Circuit in this case:

To establish aider-and-abettor liability a plaintiff must prove (1) the existence of a primary violation by another; (2) knowledge of the primary violation by the alleged aider-and-abettor; and (3) substantial assistance by the alleged aider-and-abettor in achieving the primary violation.

*First Interstate Bank of Denver, N.A. v. Pring*, 969 F.2d 891, 898 (10th Cir. 1992) (citations and footnotes omitted), *cert. granted*, 61 U.S.L.W. 3818 (U.S. June 7, 1993) (No. 92-854).

Despite the "duty to disclose" element in a primary § 10(b) claim based on failure to disclose, some courts have held that aiding and abetting liability may be imposed absent such a duty where the alleged aider and abettor gave "assistance by action"—whatever that means—to the primary violator of § 10(b). *See id.* at 903. With respect to the "knowledge" requirement, courts have established unique but amorphous and unpredictable rules applicable only to the aiding and abetting right of action that variously require proof of "actual knowledge" in some circumstances and some form of "recklessness" in others, depending on a number of variables such as duties owed

to the plaintiff, the nature of the alleged assistance to the primary violator and, in some jurisdictions, a highly fact-specific "sliding scale" of culpability. *See generally Feldman, The Breakdown of Securities Fraud Aiding and Abetting Liability: Can a Uniform Standard Be Resurrected?*, 19 Sec. Reg. Rep. 45 (1990) (discussing various rules). Moreover, the "substantial assistance" element of the proposed § 10(b) implied private right for aiding and abetting has spawned yet another separate and complex doctrinal quagmire. *See, e.g., Bromberg & Lowenfels, Aiding and Abetting Securities Fraud: A Critical Examination*, 52 Alb. L. Rev. 637, 701-39 (1988) (observing that "substantial assistance" element has "engendered a considerable amount of discussion and analysis in the cases" and discussing in detail this "rather difficult and complex area").

The doctrinal roots of the § 10(b) implied aiding and abetting right make it clear that that right is independent of the private right to sue the person who actually violates the statute. The criminal law—long viewed as a principal source of the § 10(b) aiding and abetting theory<sup>3</sup>—treats aiding and abetting as a separate and distinct offense.<sup>4</sup> In fact, in the criminal context, this Court has held that a defendant may be charged with and convicted of aiding and abetting a crime even after the "principal had been acquitted of the offense charged." *Standefer v. United States*, 447 U.S. 10, 20 (1980).

Thus, this is not a case where the Court is being asked simply to "flesh out"<sup>5</sup> the contours of a private remedy

<sup>3</sup> *See, e.g., Ruder, Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution*, 120 U. Pa. L. Rev. 597, 626 (1971).

<sup>4</sup> *See, e.g., 18 U.S.C. § 2* (one who "aids, abets, counsels or commands" is punishable as a principal); *Nye & Nissen v. United States*, 336 U.S. 613, 618-19 (1949) (distinguishing aiding and abetting from conspiracy and making clear that the former is a distinct offense).

<sup>5</sup> *Musick, Peeler*, 113 S. Ct. at 2089.

that has already been recognized under federal law. Unlike the contribution issue decided in *Musick, Peeler*, the question here is *not* how “damages are to be shared among persons or entities *already subject to . . . liability.*” *Musick, Peeler*, 113 S. Ct. at 2088 (emphasis added). It is whether to create a *new* cause of action and thereby subject an entirely new class of defendants to liability for damages under the federal securities laws for “conduct not already subject to liability through private suit.” *Id.*<sup>6</sup>

**2. The Language Of The Statute Demonstrates That Congress Did Not Intend To Establish A § 10(b) Aiding And Abetting Private Right of Action.**

The Court has repeatedly recognized that the “text of § 10(b) does not provide for private claims,” and has therefore “made no pretense that it was Congress’ design to provide the remedy afforded.” *Lampf*, 111 S. Ct. at 2779-80; *Musick, Peeler*, 113 S. Ct. at 2088 (“The private right of action under Rule 10b-5 was implied by the judiciary on the theory courts should recognize private remedies to supplement federal statutory duties, not on the theory Congress had given an unequivocal direction to the courts to do so.”); *Ernst & Ernst*, 425 U.S. at 196 (“[T]here is no indication that Congress, or the [Securities and Exchange] Commission when adopting Rule 10b-5, contemplated such a remedy.”).<sup>7</sup> While the Court in 1971

<sup>6</sup> See, e.g., Feldman, *supra* page 9, at 49-50 (observing that the “aiding and abetting theory has enormous significance because it radically expands the scope of Section 10(b) liability” to encompass a class of defendants not otherwise subject to suit).

<sup>7</sup> One of the principal drafters of SEC Rule 10b-5 recently reiterated, “Obviously neither I, nor the Commission that promulgated the Rule, had any . . . idea [that this Rule was the basis for a private suit] when the Rule was adopted.” Freeman, *Foreword to Happy Birthday 10b-5: 50 Years of Antifraud Regulation*, 61 Fordham L. Rev. S1, S2 (1993).

acquiesced<sup>8</sup> in the private right of action for violations of § 10(b) that had been recognized as implicit by the lower courts under the Court’s pre-1979 “expansive rights-creating approach,” that approach has now been “abandoned.” *Franklin v. Guinnett County Pub. Sch.*, 112 S. Ct. 1028, 1039 (1992) (Scalia, J., concurring in the judgment). Therefore, the “central inquiry” that applies to this case is whether “Congress intended to create, either expressly or by implication, a private cause of action”—here, for “aiding and abetting” the § 10(b) violation of another. *Touche Ross*, 442 U.S. at 575; see also *Musick, Peeler*, 113 S. Ct. at 2094 (Thomas, J., dissenting) (“When deciding whether a statute confers a private right of action, we ask whether Congress . . . intended to create such a remedy.”). The answer to that question is clearly no.

Indeed, since the 73rd Congress “really never knew” that a private right of action against violators of § 10(b) even “existed,” *Lampf*, 111 S. Ct. at 2780, *a fortiori* Congress did not intend to take the significant incremental step of authorizing private lawsuits for aiding and abetting § 10(b) violations. Section 10(b), on its face, “impose[s] direct liability on defendants for their own acts as opposed to derivative liability for the acts of others.” *Musick, Peeler*, 113 S. Ct. at 2090. The statute expressly prohibits persons from using a “manipulative or deceptive” device in connection with a securities transaction. It does not extend liability to persons who “aid and abet” persons who engage in such conduct.<sup>9</sup>

<sup>8</sup> See *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971); *Touche Ross*, 442 U.S. at 577-79 n.19 (“in *Superintendent* this Court simply explicitly acquiesced in the 25-year-old acceptance by the lower federal courts of an implied action under § 10(b)”).

<sup>9</sup> Section 10(b) provides only that “[i]t shall be unlawful for any person, directly or indirectly . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive



### 3. Congress Consciously Declined To Impose Aiding And Abetting Liability Under The Securities Acts.

Even if this case were viewed as another instance of the Court being "asked to specify elements or aspects of the 10b-5 apparatus unique to a private liability arrangement," *Musick, Peeler*, 113 S. Ct. at 2090, rather than to establish a whole new implied right of action, the result would be the same. Although it is an "awkward task," *Lampf*, 111 S. Ct. at 2780, the test for deciding the attributes of the § 10(b) implied private remedy is relatively straightforward. The Court "attempt[s] to infer how the [73rd] Congress would have addressed the issue had the 10b-5 action been included as an express provision in the 1934 Act." *Musick, Peeler*, 113 S. Ct. at 2089-90. In making that determination, the Court looks to the "contem-

device or contrivance . . . ." The statute thus neither makes it "unlawful" to "aid and abet" a violation nor vests private plaintiffs with a right to enforce the statute.

The only conceivable argument that § 10(b) allows for aiding and abetting prosecutions is the "directly or indirectly" language of the statute. But that phrase creates *primary* liability against a person who uses or employs an "indirect" means to perpetrate an intentional fraud; it does not create secondary liability for aiding and abetting. See *Karnes, Lenders' Liability for Aiding and Abetting Rule 10b-5 Violations: The Knowledge Standard*, 41 Sw. L.J. 925, 928 n.13 (1988) ("Although Rule 10b-5 provides for liability when the primary party perpetrates a violation indirectly, this is not secondary liability."); Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Cal. L. Rev. 81, 94 n.83 (1981) ("there is no support for the proposition that Congress intended the 'directly or indirectly' language to encompass secondary liability"). In fact, the express provisions of the 1934 Act most closely analogous to § 10(b), §§ 9 and 18, see *Lampf*, 111 S. Ct. at 2781; *Musick, Peeler*, 113 S. Ct. at 2090-91, both employ similar language and it appears that no court has ever held that those provisions create aiding and abetting liability. See § 9 of the 1934 Act, 15 U.S.C. § 78i ("It shall be unlawful for any person, directly or indirectly," to manipulate security prices.); § 18 of the 1934 Act, 15 U.S.C. § 78r (rendering liable "[a]ny person who shall make or cause to be made" misleading statements in filings relating to securities sales).

poraneously enacted express remedial provisions" enacted by the 73rd Congress, *Lampf*, 111 S. Ct. at 2780, to "ensure that the rules established to govern the 10b-5 action are symmetrical and consistent with the overall structure of the [1934] Act, and, in particular, with those portions of the Act most analogous to the private 10b-5 right of action that is of judicial creation," *Musick, Peeler*, 113 S. Ct. at 2090.

While Congress was well aware of the aiding and abetting concept and had explicitly employed it in the criminal context twenty-five years prior to its enactment of the federal securities laws,<sup>10</sup> it chose not to incorporate aiding and abetting liability into the thoughtfully structured express private remedial scheme of the 1933 and 1934 Acts. None of the express remedies included in those statutes impose civil liability in private actions for aiding and abetting a violation of the securities laws.<sup>11</sup> It is difficult to "imagine [a] clearer indication"<sup>12</sup> that the 73rd Congress would likewise have rejected the imposition of aiding and abetting liability had it decided to create a private right to enforce § 10(b). And "[i]t would indeed be anomalous to impute to Congress an intention to expand the [defendant] class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 736 (1975) (emphasis added).

The 73rd Congress also "knew of the collateral participation concept and employed it . . . throughout its unified

<sup>10</sup> Congress first enacted a general aiding and abetting criminal provision in 1909, see Act of Mar. 4, 1909, ch. 321, § 332, 35 Stat. 1152 (formerly 18 U.S.C. § 550), and that provision, with minor modification, remains part of the federal criminal law today, see 18 U.S.C. § 2.

<sup>11</sup> See Kuehnle, *Secondary Liability Under The Federal Securities Laws*, 14 J. Corp. L. 314, 321 (1988) ("aiding and abetting liability generally is not provided expressly for under the federal securities laws").

<sup>12</sup> *Lampf*, 111 S. Ct. at 2780.



program of securities regulation.” *Pinter v. Dahl*, 486 U.S. 622, 650 n.26 (1988). Congress was exceedingly specific in identifying the class of persons subject to liability. For example, it spelled out in detail the circumstances under which a broker-dealer may be held liable in a private suit for knowingly manipulating security prices, *see* § 9 of the 1934 Act, 15 U.S.C. § 78i, or “willfully participat[ing]” in a manipulation, *id.* § 78i(e). Section 11(a) of the 1933 Act, 15 U.S.C. § 77k(a), “explicitly enumerates the various categories of persons involved in the registration process who are subject to suit under that section, including many who are participants in the activities leading up to the sale.” *Pinter*, 486 U.S. at 650 n.26. Both the 1933 and 1934 Acts also impose liability on persons who exercise “control” over other persons who violate the securities laws, subject to explicit defenses. *See* § 15 of the 1933 Act, 15 U.S.C. § 77o; § 20(a) of the 1934 Act, 15 U.S.C. § 78t(a). Congress therefore deliberated and agreed on who should be held liable for collateral participation, and judicial amendment of § 10(b) to add a right of action for aiding and abetting would allow plaintiffs to circumvent the restrictions placed on such liability, trumping these express congressional judgments.

It would be particularly inappropriate to create an aiding and abetting right of action under § 10(b) in light of the fact that the 73rd Congress enacted a comprehensive legislative regime consisting of “interrelated components,” *Ernst & Ernst*, 425 U.S. at 206, without expressly including a provision proscribing aiding and abetting. As this Court has observed:

The presumption that a remedy was deliberately omitted from a statute is strongest when Congress has enacted a comprehensive legislative scheme including an integrated system of procedures for enforcement.

*Texas Indus.*, 451 U.S. at 645 (quoting *Northwest Airlines*, 451 U.S. at 97); *see also Mertens v. Hewitt Assocs.*, 113 S. Ct. 2063, 2067 (1993) (“we [have] emphasized our unwillingness to infer causes of action in the ERISA context, since the statute’s carefully crafted and detailed enforcement scheme provides ‘strong evidence that Congress did not intend to authorize other remedies that it simply forgot to incorporate expressly’”) (emphasis in original) (citation omitted). Because of the potentially sweeping expansion of liability to new defendants posed by the aiding and abetting theory, “[i]mposing liability upon traditional participants in the securities markets by resort to this theory presents greater risks of frustrating the congressional scheme of securities regulation than direct enforcement of the rule.” *Akin v. Q-L Invs., Inc.*, 959 F.2d 521, 525 (5th Cir. 1992).

Since enactment of the original securities acts, Congress has on several occasions amended those laws expressly to permit the SEC to pursue enforcement actions based on an aiding and abetting theory with respect to specific provisions. *See Kuehnle, supra* note 11, at 321 n.45; *see, e.g.*, 15 U.S.C. § 78u-2(a)(2) (§ 202 of the Securities Law Enforcement Remedies Act of 1990, authorizing the SEC to assess money penalties against persons who “willfully aided, abetted, counseled, commanded, induced, or procured” violations of certain securities laws); 15 U.S.C. § 80b-9(d) (§ 209(e) of the Investment Advisers Act, added in 1960, authorizing the SEC to prosecute any person who “aided, abetted, counseled, commanded, induced, or procured” a violation of that Act); 15 U.S.C. § 78o(b)(4)(E) (§ 15(b)(4)(E) of the 1934 Act, added in 1964, authorizing the SEC to prosecute any broker-dealer who “has willfully aided, abetted, counseled, induced, or procured the violation by any other person” of certain securities laws). But Congress has never amended the express private rights of action that it enacted in 1933 and 1934 to include aiding and abetting as a basis for a private damages action, and

in 1959 it rejected a proposal that would have created such liability.<sup>13</sup>

In short, "[w]hen Congress wished to create such liability, it had little trouble doing so," and its failure to create any private damages remedy against persons who "aid and abet" securities violations in the 1933 and 1934 Acts confirms that it "did not intend such persons to be defendants" in private actions asserted under § 10(b) or any other provision. *Pinter*, 486 U.S. at 650-51 & n.26 (rejecting imposition of liability under § 12 of the 1933 Act on secondary participants in transaction).

**4. The Court Should Refuse To Recognize A New Private Right Of Action For Aiding And Abetting A § 10(b) Violation.**

"Raising up causes of action where a statute has not created them may be a proper function for common-law courts, but not for federal tribunals." *Lampf*, 111 S. Ct. at 2783 (Scalia, J., concurring in part and concurring in the judgment). This Court should therefore decline to "raise up" an implied right of action for aiding and abetting violations of § 10(b). See also *Musick, Peeler*, 113 S. Ct. at 2088 (the Court "teach[es] that the creation of new rights ought to be left to the legislatures, not courts"); *Texas Indus.*, 451 U.S. at 646 (whether to add new private rights of action to a detailed and express remedial scheme "is a matter for Congress, not the courts, to resolve"); *Northwest Airlines*, 451 U.S. at 95 (same); *Akin*, 959 F.2d at 525 (the "formidable arguments" against § 10(b) aiding and abetting liability "have grown with the insistence that Congress legislate; that is, with increasing judicial reluctance to undertake legislative tasks").

<sup>13</sup> See *Hearing Before a Subcommittee of the Senate Committee on Banking and Currency*, 86th Cong., 1st Sess. 275-76 (1959); *Hearings Before the House Committee on Interstate and Foreign Commerce*, 86th Cong., 1st Sess. 93, 103 (1959); see also S. Rep. No. 1757, 86th Cong., 2d Sess. 9 (1960).

As the Fifth Circuit recently observed, "open-ended readings of the duty stated by Rule 10b-5 threaten to rearrange the congressional scheme," and the "added layer of liability not for directly violating Rule 10b-5 but for aiding and abetting such violation is particularly problematic." *Akin*, 959 F.2d at 525. Other courts of appeals also have increasingly "questioned the propriety of implying . . . a cause of action [for aiding and abetting a violation of § 10(b) and Rule 10b-5]" given that it is a "judge-made concept," and a product of "judicial creativity." *Renovitch v. Kaufman*, 905 F.2d 1040, 1045 n.7 (7th Cir. 1990) (citation omitted).<sup>14</sup> Even the district court that first held that such a right could properly be afforded to private litigants expressly acknowledged that Congress did not intend that result. *Brennan*, 259 F. Supp. at 680 ("there is nothing in the statute indicating a Congressional intent to impose civil liability on persons aiding and abetting violations of Section 10(b) and Rule 10b-5").

The only way to keep the sweeping "breadth" of the § 10(b) action from growing any farther "beyond the scope congressionally intended," *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2763 (1991), is to resist the temptation repeatedly to add new causes of action to the remedies already implied from § 10(b).<sup>15</sup> That is especially true in this case because engrafting an aiding and abetting private right of action to § 10(b) would nullify Congress' express policy judgments regarding who should be held liable for violating the federal securities laws. See *Ernst*

<sup>14</sup> Commentators have made the same point. See, e.g., Fischel, *supra* note 9, at 96-99 (aiding and abetting liability under § 10(b) contradicts Congress' intent).

<sup>15</sup> See, e.g., *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 473 (1977) (rejecting argument that breach of fiduciary duty claim could be asserted under § 10(b) against majority stockholders and broker who allegedly "participated" in breach because "[t]he language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception").



& *Ernst*, 425 U.S. at 210; *Blue Chip Stamps*, 421 U.S. at 736 n.8.

**B. Actual Knowledge Rather Than Recklessness Is The Appropriate Standard Upon Which To Predicate An Aiding and Abetting Violation.**

If an implied private right of action exists against § 10(b) aiders and abettors, then this Court should hold that recklessness alone is insufficient as a predicate for liability. The language of § 10(b) indicates that actual knowledge,<sup>16</sup> rather than recklessness, is the appropriate standard for § 10(b) liability of *any* kind. Moreover, the actual knowledge requirement is consistent with the plain meaning of the phrase “aid and abet”—which inherently suggests willful, knowing conduct—as well as the criminal law standard that provides the doctrinal underpinnings for § 10(b) aiding and abetting liability. And the actual knowledge requirement avoids the inherent danger to innocent and remote parties posed by the confusing and ill-defined recklessness standard—a standard that is often virtually indistinguishable from the negligence standard that this Court in *Ernst & Ernst* rejected as a basis for § 10(b) liability.

Even if this Court were to determine that recklessness may be an appropriate standard for aiding and abetting under § 10(b) in some circumstances, only actual knowledge should provide a predicate for liability where, as in this case, the defendant had no affirmative duty to act or disclose and engaged in no actual misrepresentation. The Tenth Circuit’s holding that recklessness alone may serve as a predicate for liability in this case threatens to expand the circle of individuals and entities susceptible to aiding and abetting claims well beyond that which could possibly

<sup>16</sup> Liability thus requires proof that the defendant either had actual knowledge of the alleged fraud or conscious intent to further known fraudulent conduct. See, e.g., *Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990); *Schatz v. Rosenberg*, 943 F.2d 485, 496 (4th Cir. 1991), cert. denied, 112 S. Ct. 1475 (1992).

have been intended by the Congress that enacted § 10(b), and even beyond the circle of defendants that this Court has recognized may be liable to private plaintiffs for primary § 10(b) violations. Such an increase in exposure to aiding and abetting liability would seriously undermine the legislative objective of maintaining stability and efficiency in the Nation’s securities markets.

**1. The Text Of § 10(b) Demonstrates That Actual Knowledge Is The Only Appropriate Standard Upon Which To Predicate Liability.**

“The starting point in every case involving construction of a statute is the language itself.” *Ernst & Ernst*, 425 U.S. at 197 (quoting *Blue Chip Stamps*, 421 U.S. at 756) (Powell, J., concurring)). The plain language of § 10(b) demonstrates that § 10(b) was intended to target only misconduct that is purposeful and willful. “Section 10(b) makes unlawful the use or employment of ‘any manipulative or deceptive device or contrivance’ in contravention of Commission rules.” *Id.* (quoting § 10(b)). As this Court noted in *Ernst & Ernst*, “[t]he words ‘manipulative or deceptive’ used in conjunction with ‘device or contrivance’ strongly suggest that § 10(b) was intended to proscribe *knowing* or *intentional* misconduct.” *Id.* at 199 (emphasis added).<sup>17</sup> The ordinary meaning of this “operative language” of § 10(b) suggests only deliberate and knowing conduct, not actions that are normally characterized as reckless behavior. For example, the word “manipulative” “connotes *intentional* or *willful* conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.” *Id.* at 199 (emphasis added). Similarly, the definitions of “device” and “contrivance” connote only purposive ac-

<sup>17</sup> Although the Court in *Ernst & Ernst* was concerned with whether negligence alone could be the basis for § 10(b) liability, see 425 U.S. at 193-94 n.12, the *Ernst & Ernst* analysis is equally pertinent here because the same statutory language is at issue.



tions,<sup>18</sup> and it is therefore extremely difficult to imagine a person "recklessly" "devising" or "contriving" to violate the law. Cf. *Santa Fe Indus.*, 430 U.S. at 478; *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 5-8 (1985).

The lower courts, however, have often seemed to ignore the text of § 10(b) in addressing whether recklessness is an appropriate standard for liability under § 10(b). Ironically, most courts have viewed this Court's reservation in *Ernst & Ernst* of the recklessness issue, see 425 U.S. at 193-94 n.12, as implicit approval of a recklessness standard. See, e.g., *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 44 (2d Cir.) ("[B]y leaving open the possibility that recklessness might satisfy the scienter requirement, the Supreme Court recognized that in certain instances a recklessness standard might be appropriate."), cert. denied, 439 U.S. 1039 (1978). But the express language of the statute refutes the view that recklessness can ever serve as a predicate for § 10(b) liability, let alone for "aiding and abetting" a § 10(b) violation, an entirely separate concept that itself intrinsically involves knowing and intentional misconduct.

## **2. The Actual Knowledge Standard Is Most Consistent With The Concept Of And Doctrinal Basis For Aiding And Abetting Liability.**

That actual knowledge, rather than recklessness, is the only appropriate standard for liability for aiding and abetting a § 10(b) violation is confirmed by the fact that the doctrinal basis for implying aiding and abetting liability

<sup>18</sup> See *Ernst & Ernst*, 425 U.S. at 199 n.20 (noting that "device" means "[t]hat which is devised, or formed by design; a contrivance; an invention; project; scheme; often, a scheme to deceive; a stratagem; an artifice" (quoting *Webster's International Dictionary* (2d ed. 1934))); *id.* (defining "contrivance" as "[a] thing contrived or used in contrivance; a scheme, plan, or artifice," and "contrive" as "[t]o devise; to plan; to plot . . . [t]o fabricate . . . design; invent . . . to scheme . . .") (quoting *Webster's*).

under § 10(b) is the criminal law,<sup>19</sup> which requires willful conduct to impose aider and abetting liability. The first case to recognize aiding and abetting as prohibited conduct under § 10(b) relied exclusively on the criminal law as its precedent for inferring a right of action against aiders and abettors. See *SEC v. Timetrust, Inc.*, 28 F. Supp. 34, 43 (N.D. Cal. 1939), *rev'd in part on other grounds*, 142 F.2d 744 (9th Cir. 1944). In subsequent SEC enforcement actions and private securities fraud cases, courts have continued to cite the criminal law as the doctrinal basis for aider and abetting liability under § 10(b).<sup>20</sup>

Under the criminal law, aiding and abetting liability requires that a defendant "in some sort associate himself with the venture, that he participate in it as in something that he wishes to bring about, [and] that he seek by his action to make it succeed." *Nye & Nissen*, 336 U.S. at 619 (quoting *United States v. Peoni*, 100 F.2d 401, 402 (2d Cir. 1938) (L. Hand, J.)). This standard precludes a finding of liability based upon recklessness alone. Indeed, the plain and historically accepted meaning of the phrase "aid and abet" includes the notion that the defendant acted with a "purposive attitude" in assisting the known violation of the law by another. *Peoni*, 100 F.2d at 402.<sup>21</sup>

<sup>19</sup> See, e.g., Feldman, *supra* page 9, at 47 ("Most commentators agree that the aiding and abetting concept finds its antecedents in criminal law."); see also *supra* note 3.

<sup>20</sup> See, e.g., *SEC v. Seaboard Corp.*, 677 F.2d 1301, 1311 (9th Cir. 1982); *Landy v. FDIC*, 486 F.2d 139, 163-64 (3d Cir. 1973), cert. denied, 416 U.S. 960 (1974).

<sup>21</sup> Plaintiffs and the SEC have argued that recklessness is an appropriate standard because the common law of fraud in certain circumstances allows liability to be imposed pursuant to that standard. The common law, however, does not generally recognize "aiding and abetting" liability, but rather relies on "joint tortfeasor" and "concerted action" concepts developed by the courts principally to encompass a broad array of both intentional and negligence torts causing physical injury. See Ruder, *supra* note 3, at 620-21. Tort law therefore does

### 3. The Recklessness Standard Is An Unworkable Standard.

The appropriateness of the actual knowledge standard is further confirmed by the fact that in practice recklessness is a highly uncertain standard that tends to merge with and become indistinguishable from negligence—a § 10(b) standard squarely rejected in *Ernst & Ernst*. In a slightly different context, for example, then-Justice Rehnquist expressed concern that “[r]ecklessness too easily shades into negligence” in light of the fact that recklessness is a “vaguely defined, elastic standard.” *Smith v. Wade*, 461 U.S. 30, 88, 89 n.16 (1983) (Rehnquist, J., dissenting). Indeed, “there is often no clear distinction at all between [‘recklessness’] and ‘gross’ negligence, and the two have tended to merge and take on the same meaning, of an aggravated form of negligence.” *Id.* at 72 (quoting W. Prosser, *Law of Torts* § 34, at 185 (4th ed. 1971)).

In § 10(b) cases, courts have adopted definitions of recklessness that are virtually indistinguishable from the definition of negligence, *see, e.g., Keirnan v. Homeland, Inc.*, 611 F.2d 785, 788 (9th Cir. 1980) (“if they had reasonable grounds to believe material facts existed that were misstated or omitted, but nonetheless failed to obtain and disclose such facts although they could have done so without extraordinary effort”).<sup>22</sup> Several courts have noted the

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not provide a direct analogy. Moreover, “the typical situation in which the classic tort of misrepresentation and deceit evolved was light years away from the world of commercial transactions to which Rule 10b-5 is applicable.” *Blue Chip Stamps*, 421 U.S. at 744-45; *accord Basic Inc. v. Levinson*, 485 U.S. 224, 243-44 (1988) (“The modern securities markets, literally involving millions of shares changing hands daily, differ from the face-to-face transactions contemplated by early fraud cases.”). As a result, “[r]eferences to common-law practices can be misleading” when interpreting § 10(b). *Herman & MacLean v. Huddleston*, 459 U.S. 375, 388 (1983).

<sup>22</sup> The SEC has previously observed that the *Keirnan* standard “seems close to negligence.” Brief of the Securities and Exchange Commission,

fine and constantly shifting line that separates recklessness from negligence. *See, e.g., Hoffman v. Estabrook & Co.*, 587 F.2d 509, 516-17 (1st Cir. 1978) (noting the “grey area in which negligence merges into recklessness”).<sup>23</sup>

The most-commonly invoked recklessness standard is the so-called “*Sundstrand* standard,”<sup>24</sup> which defines recklessness as “an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.” 553 F.2d at 1045. But the SEC has complained in the courts of appeals that the *Sundstrand* standard is hard to apply in practice<sup>25</sup> and imposes requirements at once too easy<sup>26</sup> and too difficult<sup>27</sup> for plaintiffs to satisfy. Thus, the SEC has advocated a standard of “conscious indifference to the truth,” *SEC Hollinger Br.*, *supra* note 22, at 14,

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*Amicus Curiae*, Regarding Rehearing En Banc, at 19, 23-24, in *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990) (No. 87-3837), *cert. denied*, 111 S.Ct. 1621 (1991) [hereinafter “*SEC Hollinger Br.*”].

<sup>23</sup> *See also Sanders v. John Nuveen & Co.*, 554 F.2d 790, 793 (7th Cir. 1977) (noting concern that “definition of ‘reckless behavior’ should not be a liberal one lest any discernible distinction between ‘scienter’ and ‘negligence’ be obliterated”); *Ackerman v. Schwartz*, 733 F. Supp. 1231, 1250 n.5 (N.D. Ind. 1989) (“‘gross negligence’ tends to merge with ‘recklessness’ taking on the same meaning”) (citing W. P. Keeton, et al., *Prosser and Keeton on the Law of Torts*, § 34, at 214 (5th ed. 1984)), *appeal dismissed*, 922 F.2d 843 (7th Cir. 1991).

<sup>24</sup> *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977).

<sup>25</sup> *SEC Hollinger Br.*, *supra* note 22, at 23 (“the *Sundstrand* standard is more complex, providing the trier of fact with less guidance in reaching an outcome in a particular case”).

<sup>26</sup> *Id.* at 24 (some courts have interpreted *Sundstrand* standard in a way that raises “the same concerns as the *Keirnan* negligence-based standard”).

<sup>27</sup> *Id.* at 23 (some courts have “conclude[d] that it imposes an ‘extremely high threshold’ that ‘is disfavored’”).



as the appropriate definition of recklessness for § 10(b) aiding and abetting. However, this definition suffers from precisely the same deficiency as other recklessness standards—namely, that it is rooted in concepts of negligence rather than intent and defies rational implementation in a manner consistent with Congress' intention that only knowingly false or misleading statements and omissions be proscribed under § 10(b). The term "conscious indifference" has, in fact, repeatedly been equated to gross negligence.<sup>28</sup>

Definitions of "recklessness" and "reckless misrepresentation" are inherently "less than precise," resulting in "ad hoc, if not arbitrary, recklessness determinations." Johnson, *Liability For Reckless Misrepresentations and Omissions Under Section 10(b) of the Securities and Exchange Act of 1934*, 59 U. Cin. L. Rev. 667, 674 (1991); see also Note, *Recklessness and the Rule 10b-5 Scienter Standard After Hochfelder*, 48 Fordham L. Rev. 817, 828 (1980) (noting the "inability of most courts to define the recklessness standard").<sup>29</sup> As a result, what one judge may view as negligent conduct, and thus unremediable under § 10(b), another judge may label as "reckless" conduct that

<sup>28</sup> See, e.g., *Ryan v. Foster & Marshall, Inc.*, 556 F.2d 460, 464 (9th Cir. 1977) ("Gross negligence in Oregon is characterized by conscious indifference to or reckless disregard of the rights of others."); *Doe v. New York City Dept. of Social Servs.*, 649 F.2d 134, 143 (2d Cir. 1981) (describing "close affinity" of gross negligence and deliberate indifference and noting the two have sometimes been "equated" though they are not "literally coextensive"), *cert. denied*, 464 U.S. 864 (1983); *Ahern v. Gaussoin*, 611 F. Supp. 1465, 1495 (D. Ore. 1985) ("Gross negligence is characterized by conscious indifference to or reckless disregard of the rights of others.").

<sup>29</sup> See, e.g., *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1025 n.36 (6th Cir. 1979) ("We think it suffices to say that the [recklessness] standard falls somewhere between intent and negligence. There is little analytical value in deciding precisely where along this spectrum recklessness falls.").

meets the requirements of that provision. See Johnson, *supra* page 24, at 674.

Examples abound of situations in which nearly identical conduct has created liability in one case but not in another despite the fact that the same recklessness standard was used. For example, in *Vucinich v. Paine, Webber, Jackson & Curtis, Inc.*, 739 F.2d 1434, 1436 (9th Cir. 1984) (*per curiam*), the Ninth Circuit held that an investor was entitled to a trial on her claim that a broker recklessly gave her bad investment advice. However, in *McDonald v. Alan Bush Brokerage Co.*, 863 F.2d 809, 815 (11th Cir. 1989), the Eleventh Circuit held that a broker was entitled to judgment as a matter of law on a claim involving facts almost identical to those in *Vucinich*. Citing *Vucinich* for its standard of intent, the Eleventh Circuit concluded that while the advice may have been "unreasonable[ ]," *id.* at 815, it was not recklessly given.<sup>30</sup>

By contrast to the uncertain and malleable recklessness standard, the actual knowledge standard is precise and capable of uniform application. As one commentator has observed,

One problem raised by the recklessness standard is that it does not provide as easy a test in application as would one requiring a showing of actual intent. The concept of recklessness belies the existence of a bright line test.

<sup>30</sup> Even within the same circuit, the recklessness standard is inconsistently applied. In *Pegasus Fund, Inc. v. Laraneta*, 617 F.2d 1335 (9th Cir. 1980), the Ninth Circuit held that an accounting firm was entitled to judgment as a matter of law with respect to whether it recklessly failed to comply with professional standards even though it had a statutorily imposed duty. In that case, the Ninth Circuit concluded that, at most, "ordinary negligence" was involved. *Id.* at 1341. However, in *SEC v. Seaboard Corp.*, 677 F.2d at 1313, the Ninth Circuit held that an accounting firm had to proceed to trial on a similar question even though the firm had not violated any explicit statutory requirements.



2 T. Hazen, *The Law of Securities Regulation* § 13.4, at 83 (2d ed. 1990).

The inevitable result of applying the recklessness standard is that innocent and remote parties have greater exposure to the threat of § 10(b) litigation and its attendant costs. As this Court has noted, "even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial." *Blue Chip Stamps*, 421 U.S. at 740. The recklessness standard makes the § 10(b) claim even more attractive to strike-suit plaintiffs by substantially increasing the probability that such a claim will survive the defendant's summary judgment motion. See, e.g., *Rudolph v. Arthur Andersen & Co.*, 800 F.2d 1040, 1045-46 (11th Cir. 1986), cert. denied, 480 U.S. 946 (1987).

The recklessness standard thus works directly to undermine the policy objectives of the Congress that enacted § 10(b), which were to devise a regulatory regime that would protect investors but not at the expense of stability and efficiency in securities markets. See generally S. Rep. No. 47, 73d Cong., 1st Sess. 1 (1933) (purpose of securities legislation is "to protect [both] the investing public and honest business"); 77 Cong. Rec. 937 (Mar. 29, 1933) (letter from President Roosevelt to Congress) ("The purpose of the legislation I suggest is to protect the public with the least possible interference to honest business."). The recklessness standard frustrates this legislative goal by creating highly uncertain and unwarranted § 10(b) liability exposure for secondary participants in securities transactions.

### C. At A Minimum, A Recklessness Standard In The Absence Of A Fiduciary Duty Is Impermissible.

The problems of the recklessness standard are aggravated where the defendant engaged in no affirmative misrepresentation and owed no duty of disclosure to the

plaintiff. Some courts, including the court below, have held that the recklessness standard applies in such circumstances. The majority of the circuits, however, have rejected this approach, holding that recklessness is the appropriate standard in a nondisclosure case only when the defendant has an affirmative duty to disclose or to act.<sup>31</sup> Otherwise, all parties with any involvement whatsoever in a securities transaction—no matter how tangential—would have potential liability exposure under § 10(b) for reckless conduct.

Application of a recklessness standard in the absence of a duty to disclose would conflict with this Court's decisions in *Chiarella*, 445 U.S. 222, and *Dirks v. SEC*, 463 U.S. 646 (1983), both of which held that § 10(b) liability may not be predicated on a defendant's silence in the absence of a duty of disclosure. As the Seventh Circuit has explained,

[w]hen the nature of the offense is a failure to "blow the whistle", the defendant must have a duty to blow the whistle. And this duty does not come from § 10(b) or Rule 10b-5; if it did the inquiry would be circular. The duty must come from a fiduciary relation outside securities law.

*Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 496 (7th Cir. 1986) (emphasis in original).

The recklessness standard imposed by the court below, in effect, creates from § 10(b) a federal duty of care and disclosure where none previously existed based solely on the fact of participation at any point in the normal chain

<sup>31</sup> See, e.g., *Schatz v. Rosenberg*, 943 F.2d 485, 496 (4th Cir. 1991); *Schneberger v. Wheeler*, 859 F.2d 1477, 1480 (11th Cir. 1988), cert. denied, 490 U.S. 1091 (1989); *Moore v. Fenez, Inc.*, 809 F.2d 297, 303-04 (6th Cir.), cert. denied, 483 U.S. 1006 (1987); *Metge v. Baehler*, 762 F.2d 621, 625 & n.1 (8th Cir. 1985), cert. denied, 474 U.S. 1057 (1986); *Cleary v. Perfectune, Inc.*, 700 F.2d 774 (1st Cir. 1983); *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 800 (3d Cir.), cert. denied, 439 U.S. 930 (1978).

of events that constitutes a routine securities transaction. Such expansion of secondary liability would upset the line drawn in *Chiarella* between those parties subject to § 10(b) liability and those that are not, and impose the kind of "duty by status" on securities professionals that the Court seemed to reject in *Dirks*.

Indeed, the Seventh Circuit has held that § 10(b) aiding and abetting liability can never be imposed where, as here, the defendant had no fiduciary duty and engaged in no affirmative misrepresentation. See *Barker*, 797 F.2d at 495-96; *LHLC Corp. v. Cluett, Peabody & Co.*, 842 F.2d 928, 932 (7th Cir.), *cert. denied*, 488 U.S. 926 (1988). Unless that is the rule, it would be easier in some cases for a plaintiff to recover against a secondary participant with only a remote link to a securities transaction than against a principal participant in the transaction. Surely, Congress did not intend that result.

Thus, the recklessness standard applied by the court below would add yet another layer to a body of judicially created law that has expanded well beyond the intent of the Congress that enacted § 10(b). There is no basis even to recognize an implied private right of action for aiding and abetting a violation of § 10(b), much less to fashion a recklessness liability standard for such a right of action.

## CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be reversed.

July 30, 1993

Respectfully submitted,

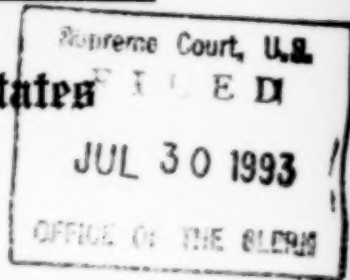
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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1993



CENTRAL BANK OF DENVER, N.A.,  
v. *Petitioner,*

FIRST INTERSTATE BANK OF DENVER, N.A. and  
JACK K. NABER,  
*Respondents.*

On Writ of Certiorari to the  
United States Court of Appeals  
for the Tenth Circuit

**BRIEF OF AMERICAN INSTITUTE  
OF CERTIFIED PUBLIC ACCOUNTANTS  
AS AMICUS CURIAE IN SUPPORT OF PETITIONER  
CENTRAL BANK OF DENVER, N.A.**

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### QUESTIONS PRESENTED

1. Whether there is an implied private cause of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5?
2. Whether recklessness satisfies the *scienter* requirement for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5?

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**BRIEF OF AMERICAN INSTITUTE  
OF CERTIFIED PUBLIC ACCOUNTANTS  
AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER  
CENTRAL BANK OF DENVER, N.A.**

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**PRELIMINARY STATEMENT**

The American Institute of Certified Public Accountants (the "Institute") submits this brief as *amicus curiae*, pursuant to Rule 37.3 of the Rules of this Court, in support of petitioner Central Bank of Denver, N.A. ("Central Bank").<sup>1</sup>

**INTEREST OF THE INSTITUTE AS *AMICUS CURIAE***

The Institute is the national organization of the certified public accounting profession, with more than 310,000 members. Among the Institute's objectives are the promotion and maintenance of accounting, auditing, and ethical standards of practice. As the authoritative source of these standards, the Institute has a profound interest in the scope and bases of civil liability sought to be imposed on accountants in connection with their professional services under the rubric of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) ("Section 10(b)" and the "1934 Act") and Rule 10b-5, 17 C.F.R. § 240.10b-5 ("Rule 10b-5") promulgated thereunder (collectively, "Section 10(b)").<sup>2</sup>

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<sup>1</sup> The Institute's brief is submitted on written consents of the parties, which have been filed contemporaneously herewith.

<sup>2</sup> The Institute was invited to and did testify before the United States Senate concerning the scope of civil liability and damages to be provided in the 1934 Act. *Hearings on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 Before the Committee on Banking and Currency of the United States Senate, 73d Cong., 1st Sess., pt. 15 at 7207-10 (1934)*. The Institute has also participated as *amicus curiae* in a number of cases in this Court concerning related securities laws issues, including *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979), *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), and *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 113 S. Ct. 2085 (1993).



The questions presented in this case transcend the interests of the parties and are of particular importance to the Institute and its members. The recognition and expansive application by the lower courts of an implied private cause of action for aiding and abetting a violation of Section 10(b) has resulted in an uncontrolled and incoherent expansion of secondary liability against accountants and other professional service providers for conduct that, by definition, does not constitute a primary violation of that provision. Accountants, whose role in auditing and reporting on the financial statements of public companies makes them inviting "deep pocket" targets, are routinely sued for aiding and abetting under the statute.

The resultant liability explosion has greatly increased the costs of accounting services and has forced many mid-sized and small accounting firms to cease or curtail providing auditing services. Even the largest accounting firms have refrained from providing such services to new technology and other high-risk industries for fear of Section 10(b) litigation. In light of these severe consequences, the Institute and its members are greatly interested in this Court's review of the questions presented herein.

## INTRODUCTION AND SUMMARY OF ARGUMENT

### A.

Recognizing an implied private cause of action for aiding and abetting under Section 10(b) would by definition impose liability, based on conduct which, standing alone, does not constitute a violation of the statute, upon persons whom the statute by its terms does not reach. The two questions presented in this case actually provide alternative ways of addressing what is essentially a single issue: whether persons who engage in certain acts which in and of themselves do not violate Section 10(b), and who are not in a statutorily-established class of persons derivatively liable by virtue of status, may nonetheless be liable under the statute for those acts.

The more direct, doctrinally sound, and efficient approach would be to recognize that there is simply no

warrant in the language or structure of Section 10(b) to engraft upon it an implied cause of action for aiding and abetting a violation of its terms. A somewhat less effective approach would permit finding liability for aiding and abetting only when a defendant actually knows that wrongful activity violative of Section 10(b) is being committed and intentionally provides substantial assistance to the primary violator in perpetrating the scheme.

In most cases, there would be little, if any, difference in outcome between the two approaches, since the standard of *scienter* proposed would make a defendant liable only if its conduct was tantamount to at least an "indirect" primary violation. The Institute submits, nevertheless, that fidelity to the techniques of statutory analysis announced by this Court, a proper concern for clarity and coherence in defining the scope of liability-producing statutes, and clear advantages in efficiency and policy favor rejection of an implied aiding and abetting cause of action under Section 10(b).

### B.

This Court's recent decision in *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 113 S. Ct. 2085, 2088-89 (1993), holds that there are two modes of analysis which may apply in determining whether a cause of action should be implied under Section 10(b). Under either mode, no cause of action for aiding and abetting can be implied here. If, as the Institute submits, recognition of an implied private right of action for aiding and abetting would create a new cause of action, then the traditional inquiries into the statutory text, scheme, and legislative purpose must be made. If, on the other hand, resolution of the issue is viewed as a matter of defining the contours of the existing implied right of action for primary violations of Section 10(b), reference must be made to the other express liability provisions of the 1933 and 1934 Acts to determine how Congress would have addressed aiding and abetting liability had it considered the issue.

There is no evidence, under either mode of analysis, that Congress intended to impose liability under Section 10(b) for any conduct beyond the statute's express prohibitions.

Neither Section 10(b) nor Rule 10b-5 imposes liability or provides any express remedy for aiding and abetting, and the underlying structure of the 1934 Act's statutory scheme negates the existence of such liability. Moreover, none of the other express civil liability provisions in the 1933 and 1934 Acts, including those this Court has found most analogous to Section 10(b), provides for aiding and abetting liability. The lack of any express private civil remedy for aiding and abetting in the federal securities laws strongly suggests that Congress would not have imposed such liability under Section 10(b) had it considered the issue.

### C.

Because Congress has not expressly authorized aiding and abetting liability, if the Court were to recognize such a private cause of action, it should exercise caution in establishing the scope of such liability. In that case, the same canons of statutory construction used to define the *scienter* requirements of a primary violation would require both *actual knowledge* of a primary violation and a *conscious intent* to assist substantially in that violation before aiding and abetting liability can attach under Section 10(b). These stringent *scienter* requirements will ensure that a sufficient nexus exists between the alleged aider and abettor's conduct, which itself is, by hypothesis, not actionable under Section 10(b), and the "manipulative or deceptive" acts proscribed by the statute. And they will tend to limit the risks to coherent, consistent, and predictable application of the law inherent in any recognition of aiding and abetting liability by restricting exposure to those defendants who have engaged in truly egregious conduct in furtherance of a Section 10(b) violation.

## ARGUMENT

### I. A PRIVATE CAUSE OF ACTION FOR AIDING AND ABETTING UNDER SECTION 10(b) WAS NOT INTENDED BY CONGRESS AND SHOULD BE REJECTED BY THIS COURT.

Recognition of an implied private cause of action for aiding and abetting under Section 10(b) would expand dramatically the class of conduct that could give rise to liability under the statute. Indeed, the sole reason for recognizing liability for aiding and abetting is to reach conduct that does not constitute a primary violation of Section 10(b). At the heart of this case, therefore, is the question whether Congress intended to impose liability under Section 10(b) for conduct which itself is not expressly prohibited, on a party who is not, by category or classification, within the class of wrongdoers that have been recognized to be covered by the statute.<sup>3</sup>

This Court has twice reserved the question whether civil liability for aiding and abetting is appropriate under Section 10(b) and Rule 10b-5, and, if so, the elements necessary to establish such a cause of action. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 191-92 n.7 (1976); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 379 n.5 (1983). In the absence of a ruling by this Court, the Tenth Circuit and other lower federal courts have assumed the existence of aiding and abetting as a separate cause of action, permitting recovery under Section 10(b) from parties who themselves have not violated the statute, but who have allegedly assisted another in doing so. The lower courts have borrowed from criminal and common law tort concepts of aiding and abetting in recognizing this cause of action, with little or no attempt to address

<sup>3</sup> In this regard, aiding and abetting is distinguishable from other types of secondary liability, such as *respondeat superior* and controlling person liability, which involve the question whether certain parties may be held vicariously liable for a primary violation on the basis of their status or relationship to the primary violator. Aiding and abetting, in contrast, involves the creation of a new class of conduct for which liability may be imposed.



whether Congress ever intended to create liability for aiding and abetting under Section 10(b). See Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Cal. L. Rev. 80, 93-94 (1981) ("Secondary Liability").

That analysis is plainly inadequate to justify expanded liability under Section 10(b). This Court has long instructed that the existence of an implied private right of action is a question of congressional intent, and that reliance on tort principles to resolve that question "is entirely misplaced." *Touche Ross & Co. v. Redington*, 442 U.S. 560, 568 (1979).

The Court's recent decisions in *Musick, Peeler*, 113 S. Ct. at 2087-89, *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2763-64 (1991), and *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773, 2780 (1991), set forth a two-step process for adjudicating questions involving causes of action implied under the federal securities laws. Where the question is whether to recognize a new cause of action, the Court has held it will do so only upon a showing of clear congressional authorization, stating that "the creation of new rights ought to be left to legislatures, not courts." *Musick, Peeler*, 113 S. Ct. at 2088. The Court will therefore look for demonstrative evidence in the statutory text and scheme that Congress intended to create such a right. See *id.*; *Virginia Bankshares*, 111 S. Ct. at 2764.

Where the question at issue does not involve the creation of a new cause of action, but rather involves elaboration of the scope of an action already implied by the judiciary, the Court will look to the most analogous express causes of action contained in the securities laws to determine how Congress would have resolved the question had it considered providing the private right of action when enacting the statute. *Musick, Peeler*, 113 S. Ct. at 2090.

Whether aiding and abetting liability be considered a new cause of action or an amplification of the contours of an existing one, it cannot survive the analyses required by this Court's decisions.

**A. Recognizing Aiding And Abetting Liability Under Section 10(b) Would Create A New Cause Of Action, For Which There Is No Evidence Of Congressional Intent.**

**1. Implied Aiding And Abetting Liability Would Be A New Cause Of Action.**

In its most recent decisions addressing the scope of private damages actions implied by the courts under the federal securities laws, this Court has drawn a careful distinction between expanding the scope of damages liability beyond its existing limits and "fleshing out" the contours of the liability already recognized by this Court. In *Musick, Peeler*, for example, the question was whether persons jointly liable for damages under Section 10(b) may seek contribution from one another. The Court recognized that "the creation of new rights ought to be left to legislatures, not the courts." 113 S. Ct. at 2088. It concluded, however, that the claim in contribution did not constitute a "new right[]" because the defendants in contribution already were subject to damages liability for primary violations of Section 10(b) under the Court's existing jurisprudence. *Id.*

As explained by the Court, "[t]he parties against whom contribution is sought are . . . persons or entities alleged to have violated existing securities laws and who share joint liability for that wrong under a remedial scheme established by the federal courts." *Id.* (emphasis added). The duty in question was "but the duty to contribute for having committed a wrong that courts have already deemed actionable under federal law." *Id.*

Significantly, the Court stated that the argument that contribution constituted a new cause of action—and therefore was proper only if expressly authorized by Con-



gress—"would have much force were the duty to be created . . . one governing conduct not already subject to liability through private suit." *Id.* It was the fact that the case involved the allocation of damages "among persons or entities already subject to . . . liability" that allowed the Court to permit contribution claims in the absence of clear congressional authorization. *Id.*

The question whether an implied private cause of action for aiding and abetting should be recognized under Section 10(b) falls squarely on the other side of the line drawn by this Court in *Musick, Peeler*. The sole reason for allowing a cause of action for aiding and abetting is to impose liability on persons *not* subject to liability under the standards set forth in this Court's prior decisions. By recognizing such a cause of action, therefore, the Court would be creating a new species of liability for "conduct not already subject to liability through a private suit," precisely the situation in which *Musick, Peeler* indicates that congressional authorization is required, so that the Court may avoid trenching on the prerogatives of the legislative branch. *Id.*

This conclusion is reinforced by the Court's reasoning in *Virginia Bankshares*, 111 S. Ct. 2749 (1991). There, the Court viewed a proposed relaxation of the causation requirements of an implied private cause of action under Section 14(a) as an "expansion" or "extension" of liability that could only be justified by a clear manifestation of congressional intent. *Id.* at 2763. Although a substantial number of lower courts had adopted the more expansive causation theory, the Court admonished that "the legitimacy of any such extension or expansion . . . must ultimately rest on congressional intent to provide a private remedy." *Id.* (citing *Touche Ross*, 442 U.S. at 575). After finding "no manifestation of [congressional] intent to recognize a cause of action (or class of plaintiffs) as broad as [the] respondents' theory of causation would entail," the Court refused to recognize the proposed new theory and rejected the lower court decisions adopting it. *Id.* at 2763, 2765.

Aiding and abetting liability, by its very nature, would extend and expand the class of persons subject to suit under Section 10(b). For the reasons enunciated in *Musick, Peeler* and *Virginia Bankshares*, therefore, recognition of aiding and abetting liability under Section 10(b) would constitute a new cause of action, requiring a clear manifestation of congressional intent.

**2. *There Is No Evidence Of Any Congressional Intent To Provide A Private Civil Damages Remedy For Aiding And Abetting A Violation Of Section 10(b).***

The requisite congressional intent to create a private cause of action for aiding and abetting a primary violation of Section 10(b) is clearly lacking. This Court repeatedly has recognized that Congress did not intend to provide for private actions against primary violators when it enacted the statute.<sup>4</sup> See *Lampf, Pleva*, 111 S. Ct. at 2779-80 (private action is "of judicial creation"); accord *Musick, Peeler*, 113 S. Ct. at 2088. It is indisputable, therefore, that Congress did not intend to create a private action against aiders and abettors. Even if Congress had included in Section 10(b) a substantive provision against aiding and abetting (so that, for example, the SEC could proceed against aiders and abettors pursuant to its separate statutory power to seek injunctive relief for any violations of the 1934 Act), that would not have manifested an intent by Congress to authorize private actions against aiders and abettors; and Congress, of course, did not even go that far. In the absence of the requisite congressional intent, this Court should not recognize such a new cause of action.

Moreover, there is considerable evidence that Section 10(b) does not even reach aiding and abetting.<sup>5</sup> "The

<sup>4</sup> Because the questions presented here involve analysis of whether a private cause of action for civil aiding and abetting should be implied under Section 10(b), such analysis does not implicate the SEC's enforcement powers or the bases of such powers.

<sup>5</sup> Of course, the Court need not resolve this question in order to conclude that Respondents may not maintain a private damages

starting point in every case involving construction of a statute is the language itself.” *Ernst & Ernst*, 425 U.S. at 197 (citations omitted). Section 10(b) provides that “[i]t shall be unlawful for any person, directly or indirectly . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance . . . .” 15 U.S.C. § 78j(b). The statute does not expressly prohibit aiding and abetting, and Rule 10b-5 is equally silent on the issue. The absence of any express language making it unlawful to aid and abet violations of Section 10(b) thus “is strong evidence that Congress did not intend to impose such liability upon conduct which would not otherwise be prohibited as a ‘manipulative or deceptive practice.’” *Secondary Liability*, 69 Cal. L. Rev. at 95.

This Court in other contexts has carefully limited the contours of Section 10(b) to conduct expressly proscribed by the statute. In *Ernst & Ernst*, 425 U.S. at 200-02, 212, for example, this Court held that the “manipulative or deceptive” language of Section 10(b) embraces intentional conduct only, thus requiring a showing of *scienter*. In so holding, the Court stated, in words of particular import here, that “[w]hen a statute speaks so specifically in terms of manipulation and deception . . . and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute.” *Id.* at 214. The Court repeated these very same words in *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 473-74 (1977), reaffirming that the language of Section 10(b) “gives no indication that Congress meant to prohibit any conduct . . . [that cannot] be fairly viewed as ‘manipulative or deceptive’ within the meaning of the statute.” Similarly, in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 749 (1975), this Court held that the plaintiffs were not entitled to sue for alleged violations of Rule 10b-5, because they were neither “purchasers” nor “sellers” within the meaning of Section 10(b). The rationale

action against aiders and abettors. The absence of congressional authorization of private actions is dispositive of that issue.

adopted by the Court in *Blue Chip Stamps* for refusing to expand the ambit of plaintiffs who could sue on the basis of conduct not covered by the statute equally supports the view that the Court should not expand the ambit of defendants who can be sued for conduct not covered by the statute. By holding that the scope of Section 10(b) cannot be extended to conduct it does not expressly proscribe, these precedents make clear that the statute allows no room for aiding and abetting, which by its very nature involves conduct that the statute itself does not expressly proscribe.

Finally, the statutory scheme of the 1934 Act further negates any intent by Congress to reach aiding and abetting under Section 10(b). In contrast to Section 10(b), Congress has provided explicit statutory authority for addressing aiding and abetting offenses in other provisions of the federal securities laws. For example, Section 15(b)(4)(E) of the 1934 Act (15 U.S.C. § 78o(b)(4)(E)) expressly authorizes the SEC to discipline a broker or dealer who “has willfully aided [or] abetted . . .” violations of the securities laws. Congress’ express treatment of aiding and abetting liability in the context of this administrative enforcement provision demonstrates, in the words of this Court, that “when Congress wished to provide [such a] remedy, it knew how to do so and did so expressly.” *Touche Ross*, 442 U.S. at 572.\*

\* Further evidence of Congress’ ability to legislate express remedies for aiding and abetting is found in other provisions of the federal securities laws. Section 203(e)(5) of the Investment Advisers Act, 15 U.S.C. § 80b-3(e)(5), for example, authorizes the SEC to discipline investment advisers and companies that aid or abet securities laws violations. Section 9(b)(3) of the Investment Company Act, 15 U.S.C. § 80a-9(b)(3), similarly empowers the SEC to bar from service with any investment company or related organization any “willful” aider or abettor of a securities violation. The Commodity Exchange Act (the “CEA”) contains like provisions for administrative discipline based on aiding and abetting. See 7 U.S.C. § 12a(2)(E)(ii) (denial or revocation of registration); 7 U.S.C. § 12a(3)(A) (denial of registration); 7 U.S.C. § 12a(3)(K)(ii) (same); 7 U.S.C. § 12a(4) (refusal, revocation,



The absence of any such express reference in Section 10(b), and in the other provisions of the 1934 Act that it resembles (*see* page 13, *infra*), provides strong evidence that Congress did not intend Section 10(b) to reach aiding and abetting.<sup>7</sup>

modification, or restriction of registration). Section 13c(a) of the CEA further provides that "[a]ny person . . . who willfully aids [or] abets . . . a violation of [the Act] . . . may be held responsible for such violation as a principal." 7 U.S.C. § 13c(a).

<sup>7</sup> The point is emphasized by considering what Congress chose not to do. An effort was made in 1959 to amend the statutory scheme of the 1934 Act to make it unlawful "for any person to aid [or] abet . . . the violation of any provision of the [1934 Act] or rule or regulation thereunder." H.R. 5001 and S. 1178, 86th Cong., 1st Sess. (1959), reprinted in *Securities Acts Amendments, 1959: Hearings on H.R. 5001 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 86th Cong., 1st Sess. 89, 103 (1959). In response to industry representatives' fears that the proposed legislation would result in the imposition of secondary liability in private suits, the SEC agreed to clarify the bill to indicate that "no civil liability is intended." *SEC Legislation: Hearings Before a Subcomm. of the Senate Comm. on Banking and Currency on S. 1178, S. 1179, S. 1180, S. 1181, and S. 1182*, 86th Cong., 1st Sess. 288, 292 (1959). The SEC position was a plain indicator that the agency did not then believe that the already existing terms of the statute created civil liability for aiding and abetting. The proposed legislation was never enacted. The similar history of a companion provision in the 1959 legislative package was considered pertinent by the Court in *Blue Chip Stamps*, 421 U.S. at 732-33, in concluding that Congress had not intended to expand the cause of action under Section 10(b) beyond "purchasers" and "sellers."

Notably, contemporaneous legislation was enacted amending the Investment Advisers Act to empower the SEC to exercise its enforcement powers against aiders and abettors. Amendments to Investment Advisers Act of 1940, Pub. L. No. 86-750, 74 Stat. 885 (Title 15, § 209(e)) (current version at 15 U.S.C. § 80b-9(d) (1988)).

Taken as a whole, this legislative history demonstrates that, when Congress considered the issue of aiding and abetting in the context of the securities laws, it deliberately restricted the scope of liability to administrative enforcement actions and chose not to provide private damages actions for such conduct.

## **B. Aiding And Abetting Liability Cannot Be Imputed As A "Contour" Of The Existing Private Right Of Action For Primary Violations Of Section 10(b).**

Even if aiding and abetting liability were not considered as a new cause of action, but rather as a "contour" of the existing Section 10(b) action, there is no indication Congress would have imposed such liability had it considered the question. In "rounding out" the scope and elements of Section 10(b) liability, the Court has sought "to ensure that the rules established to govern the 10b-5 action are symmetrical and consistent with the overall structure of the Act and, in particular, with those portions of the Act most analogous to the private 10b-5 right of action that is of judicial creation." *Musick, Peeler*, 113 S. Ct. at 1090. Where there is "convincing" evidence of what Congress would have done had it known that Section 10(b) would be the basis for a private cause of action, the Court will shape the implied cause of action in accord with that evidence. *Id.* An examination of the provisions most analogous to Section 10(b) confirms that there is no basis for creating a civil remedy for aiding and abetting under the statute.

The Court has previously found that Sections 9 and 18 of the 1934 Act (15 U.S.C. §§ 78i and 78r) "are clos[est] in structure, purpose and intent to the 10b-5 action." *Musick, Peeler*, 113 S. Ct. at 2090; *Lampf, Pleva*, 111 S. Ct. at 2781. As explained by the Court, the two provisions are of "particular significance in determining how Congress would have resolved" questions concerning the contours of Section 10(b) liability, because they not only "target the precise dangers that are the focus of § 10(b)," *Lampf, Pleva*, 111 S. Ct. at 2781, but also "impose liability upon defendants who stand in a position most similar to 10b-5 defendants . . . ." *Musick, Peeler*, 113 S. Ct. at 2090. Given the significance of these provisions to the Section 10(b) analysis, it is critically relevant that neither Section 9 nor Section 18 provides a private cause of action for aiding and abetting. This fact



alone requires rejection of any implied liability for aiding and abetting.<sup>8</sup>

Moreover, in construing these analogous liability provisions, courts have generally concluded that they do not impose aiding and abetting liability. Only one reported case has expressly recognized aiding and abetting liability under Section 18. *In re Caesars Palace Sec. Litig.*, 360 F. Supp. 366 (S.D.N.Y. 1973). The court justified such liability in that case by reference to the "broad, remedial nature" of the federal securities laws. *Id.* at 382. That rationale, doubtful in 1973, is clearly obsolete twenty years later, since this Court has repeatedly held in the intervening decades that these remedial goals do not justify imposing liability under a statute "more broadly than its language and the statutory scheme reasonably permit." *Pinter v. Dahl*, 486 U.S. 622, 653 (1988) (citations omitted). Probably in light of this now settled jurisprudence, no court since *Caesars Palace* has imposed aiding and abetting liability under Section 18.

There similarly has been no significant consideration of aiding and abetting liability under Section 9. The Institute is aware of only one reported case in which aiding and abetting liability was imposed, without analysis, under that provision as part of a larger Section 10(b) action. *See Sennott v. Rodbart*, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,851 (N.D. Ill. 1970). The decision was subsequently reversed by the Seventh Circuit on the ground that there was no evidence the alleged aiders and abettors had knowledge of the underlying securities violations. *Sennott v. Rodman & Renshaw*, 474 F.2d 32, 39 (7th Cir.), *cert. denied*, 414 U.S.

<sup>8</sup> None of the remaining six express liability provisions of the 1933 and 1934 Acts provides such a remedy. These provisions include Sections 11, 12, and 15 of the 1933 Act (15 U.S.C. §§ 77k, 77l, and 77o), and Sections 16, 20, and 20A of the 1934 Act (15 U.S.C. §§ 78p, 78t, and 78t-1).

926 (1973). Having made this factual determination, the Seventh Circuit had no occasion to address the question whether there is an implied private cause of action for aiding and abetting under Section 9.

Among the other express liability provisions of the federal securities laws, *see* note 8, *supra*, the only notable discussion of aiding and abetting liability has centered on Sections 11 and 12 of the 1933 Act. The relevant cases reveal a strong judicial trend toward rejecting aiding and abetting liability under these provisions, as well. Most of the courts that have considered the issue under Section 11 have concluded that the statute's plain language does not impose aiding and abetting liability.<sup>9</sup> This result is consistent with the Court's decision in *Herman & MacLean v. Huddleston*, 459 U.S. at 382 n.13, which held that "[a] § 11 action can be brought only against certain parties such as the issuer, its directors or partners, underwriters, and accountants who are named as having prepared or certified the registration statement."

This Court's decision in *Pinter v. Dahl*, 486 U.S. at 651, strongly suggests that there is also no aiding and abetting liability under Section 12. At issue in *Pinter* was whether a long line of lower court decisions had properly extended primary liability under Section 12(1) beyond traditional defendant-sellers, as defined in the Act, to others "whose participation in the buy-sell transaction [was] a substantial factor in causing the transaction to take place." *Id.* at 649 (citations omitted). By rejecting the proposed "substantial factor" test and restricting liability to "sellers," the Court negated the viability of aiding and abetting liability under the statute.<sup>10</sup>

<sup>9</sup> *See, e.g., Hagert v. Glickman, Lurie, Eiger & Co.*, 520 F. Supp. 1028, 1034 (D. Minn. 1981); *McFarland v. Memorex Corp.*, 493 F. Supp. 631, 642 (N.D. Cal. 1980); *In re Equity Funding Corp. of America Sec. Litig.*, 416 F. Supp. 161, 181 (C.D. Cal. 1976).

<sup>10</sup> Although the Court declined to address whether the same restrictions applied to Section 12(2), courts have almost uniformly denied the existence of aiding and abetting liability under that provision as well. *See, e.g., Ackerman v. Schwartz*, 947 F.2d 841

In short, neither the analogous liability provisions of the 1933 and 1934 Acts nor the weight of the case authorities construing those provisions provides any evidence that Congress would have created a private cause of action for aiding and abetting under Section 10(b) had it considered the issue. There is simply no basis for implying such a right as part of the "contour" of the existing Section 10(b) cause of action.

Thus, unlike *Musick*, *Peeler* and *Lampf*, *Pleva*, where the statutory scheme revealed with clarity what Congress would have done with respect to the Section 10(b) cause of action, there is no "convincing" evidence here that Congress would have authorized private actions against aiders and abettors. Given the expansion in liability that would result from permitting such claims, and the absence of any clear congressional directive authorizing them, the Court should stay its hand. If Congress believes that this additional category of liability is a necessary supplement to the existing Section 10(b) action and the other actions under the federal securities laws, Congress can make appropriate provision for it.<sup>11</sup>

(7th Cir. 1991); *Craftmatic Sec. Litig. v. Kraftsow*, 890 F.2d 628 (3d Cir. 1989); *Wilson v. Saintine Exploration & Drilling Corp.*, 872 F.2d 1124 (2d Cir. 1989).

<sup>11</sup> The fact that aiding and abetting has gained some recognition under tort law does not provide any basis for expanding the Section 10(b) action to encompass such claims. This Court repeatedly has rejected the contention that Section 10(b) incorporates the standards governing common law tort liability. "[T]he typical fact situation in which the classic tort of misrepresentation and deceit evolved was light years away from the world of commercial transactions to which Rule 10b-5 is applicable." *Blue Chip Stamps*, 421 U.S. at 744-45; see also *id.* at 747-49 (refusing to construe Section 10(b) action in accordance with common law); *Basic Inc. v. Levinson*, 485 U.S. at 244 n.22 ("[a]ctions under Rule 10b-5 are distinct from common-law deceit and misrepresentation claims"). In the absence of any indication that Congress would have authorized aiding and abetting claims, therefore, there is no warrant for incorporating this aspect of the common law into the private action implied under Section 10(b).

**C. Aiding And Abetting Liability Exposes Accountants And Other Third Parties To Disproportionate Liability, Disrupts The Provision Of Vital Professional Services To The Public, And Raises Other Serious Policy Issues Never Addressed By Congress.**

The practical consequences of allowing for the imposition of aiding and abetting liability under Section 10(b) raise a number of serious policy questions never addressed by Congress. In the absence of clear congressional intent, these policy concerns weigh heavily against implication of a private cause of action for aiding and abetting, whether as a new cause of action or as an expansion of the existing private right. See *Blue Chip Stamps*, 421 U.S. at 737; *Ernst & Ernst*, 425 U.S. at 214-15 n.33.

Experience teaches that among the most obvious targets of civil aiding and abetting accusations in securities actions are those professionals who provide necessary ancillary services to principal actors in the marketplace. There has been a flood of class action lawsuits and other cases in which accountants and other professionals have been required to defend through costly discovery or trial against claims of aiding and abetting. Accountants are often viewed as attractive defendants by plaintiff investors searching for the most solvent "deep pocket" they can find. See *Lochner, Black Days for Accounting Firms*, Wall St. J., May 22, 1992, at A10, col. 4; Mednick, *Accountants' Liability: Coping with the Stampede to the Courtroom*, J. Acct., Sept. 1987, at 118. The effects of this litigation explosion on the accounting profession have been "particularly acute," 138 Cong. Rec. S12,604 (daily ed. Aug. 12, 1992) (statement of Sen. Sanford on S. 3181, Securities Private Enforcement Act of 1992), resulting in virtually limitless liability, high insurance premiums, and the increasing unavailability of insurance. See, e.g., Gossman, *The Fallacy of Expanding Accountants' Liability*, 1 Colum. Bus. L. Rev. 213, 215, 228-31 (1988); Minow, *Accountants' Liability and the Litigation Explosion*, J. Acct., Sept. 1984, at 70.



In commenting on the explosion of securities fraud litigation against accounting firms, Senator Sanford (for himself and Senator Domenici) noted that "[t]he mounting evidence simply does not support the notion that most of this litigation is meritorious." 138 Cong. Rec. S12,599, S12,605. To the contrary, of all 10b-5 actions filed against the six largest accounting firms which concluded in 1991, the total amount of settlements and judgments paid by the firms was only 3 percent of the claimed damages. *Id.* at S12,605. While these results underscore the weakness of such claims, in 83 percent of the cases the accounting firms were required to pay \$8 in legal fees for every \$1 ultimately paid to the plaintiffs. *Id.*

In recent testimony before the Securities Subcommittee of the United States Senate Committee on Banking, Housing and Urban Affairs, the Chairman of the Institute reflected on the continuing severe consequences expanded Section 10(b) liability has had on the accounting profession. *Hearings on Private Litigation Under the Federal Securities Laws*, 103d Cong., 1st Sess. (July 21, 1993) (statement of Jake L. Netterville, Chairman of the Board of Directors, American Institute of Certified Public Accountants). After noting that independent auditors often settle even frivolous 10b-5 suits due to the potential for joint and several liability and the "enormous" defense costs associated with such suits,<sup>12</sup> Mr. Netterville stated

<sup>12</sup> The accounting profession's experiences with settling even frivolous class action lawsuits are not atypical. As Judge Ralph K. Winter of the Second Circuit explained in the 1992 Holmes Lecture at Harvard Law School, "[b]ecause the motivation for bringing the action is the quest for attorney's fees, many such actions may be brought on the basis of their settlement value, which may be related more to the expected costs of defense than to the merits of the underlying claim." Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 Duke L.J. 945, 949 (1993). See also Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497 (1991), which describes in detail the increasing pressure to settle securities actions on bases unrelated to their merits, and analyzes the erosion of the

that growing numbers of smaller and mid-sized accounting firms have stopped performing audits or significantly reduced such services. *Id.* at 5. The larger accounting firms have also been forced to focus their risk management efforts on "avoiding those clients and potential clients that present the greatest likelihood of litigation." *Id.* at 6. These clients are typically the start-up and growth companies "whose futures are least assured and whose stock prices are most volatile . . . . Yet these are the very entities our country looks to for technological innovation, the bulk of job creation, and future competitive strength." *Id.*

As this evidence demonstrates, the lower courts' recognition of aiding and abetting liability under Section 10(b) has, in the words of this Court, "extend[ed] to new frontiers the 'hazards' of rendering expert advice under the Acts," *Ernst & Ernst*, 425 U.S. at 214 n.33 (citations omitted), and opened the door to the very type of "vexatious litigation" the Court warned against in *Blue Chip Stamps*, 421 U.S. at 742-43. It has forced accountants and other professionals to restrict their services, significantly increased the costs of ordinary securities transactions, and disrupted the free flow of financial information so critical in today's increasingly complex financial marketplace. Congress surely never intended such results when it struck the careful balance between full and fair disclosure of material information and efficient operation of the securities markets reflected in Section 10(b) and the other provisions of the federal securities laws. In light of these serious policy considerations, this Court should decline to embrace aiding and abetting liability and instead defer to Congress on the matter.

#### **D. Other Remedies Are Available To Redress Accountant Misconduct.**

Aiding and abetting liability is neither an exclusive nor necessary remedy for misconduct by accountants. Ac-

normative authority of the laws such actions are meant to enforce that is implicit in the trend.



countants who engage in "manipulative or deceptive" practices with respect to securities transactions may be fully liable for primary violations of Section 10(b). Other provisions of the federal securities laws,<sup>13</sup> various state laws, as well as actions for common law fraud and negligence,<sup>14</sup> provide additional remedies for alleged accountant misconduct. Professional standards imposed by state regulatory authorities and the Institute establish further enforcement mechanisms to redress improper behavior. See AICPA & NASBA Digest of State Accountancy Laws and State Board Regulations 1987-88 (1988); *Principles of Professional Conduct*, AICPA Professional Standards §§ 50-57 (Am. Inst. of Certified Pub. Accountants June 1, 1991). Refusal by this Court to recognize an implied private cause of action for aiding and abetting, therefore, will not leave private litigants or the SEC without adequate alternative remedies, or the public interest unprotected.

**II. TO THE EXTENT THIS COURT RECOGNIZES AN IMPLIED PRIVATE CAUSE OF ACTION FOR AIDING AND ABETTING, IT SHOULD REQUIRE A SHOWING OF ACTUAL KNOWLEDGE OF THE PRIMARY VIOLATION AND A CONSCIOUS INTENT TO ASSIST IN ITS ACHIEVEMENT.**

Should this Court decide to imply a private cause of action for aiding and abetting under Section 10(b), the Court should reject the recklessness standard adopted below and instead require a showing of actual knowledge of the primary violation and a conscious intent to assist substantially in its achievement in order to satisfy the *scienter* requirement for aiding and abetting.<sup>15</sup>

<sup>13</sup> See, e.g., 15 U.S.C. § 77k(a) (4) (imposing liability on accountants and other professionals, in certain circumstances, for misrepresentations in financial statements included in registration statements).

<sup>14</sup> See Haft, *Liability of Attorneys and Accountants for Securities Transactions* §§ 5.01-5.04 (1992).

<sup>15</sup> This Court has previously reserved the question whether recklessness may suffice, under certain circumstances, to establish

Although the federal circuits have adopted varying formulations of the elements for aiding and abetting under Section 10(b), generally speaking they are: (1) a violation of Section 10(b) by a primary party (as opposed to the alleged aider and abettor); (2) knowledge of that violation on the part of the alleged aider and abettor; and (3) the knowing rendering of substantial assistance by the alleged aider and abettor in achieving the primary violation.<sup>16</sup>

Because aiding and abetting liability stems from a separate primary violation, proving the offense necessarily requires evidence of two distinct mental states, as reflected in the second and third elements: There must be some degree of knowledge of the primary violation, coupled with some degree of knowledge of the aider and abettor's role in assisting that violation. The Institute respectfully urges this Court to address both mental states in determining the *scienter* requirements for aiding and abetting liability. Moreover, because aiding and abetting liability is one step removed from a primary violation and greatly expands the class of persons subject to suit, the Institute believes that stringent *scienter* requirements should be adopted for aiding and abetting to ensure a sufficient nexus exists between the conduct giving rise to such liability and the conduct actually proscribed in Section 10(b).

*scienter* under Section 10(b). See *Aaron v. SEC*, 446 U.S. 680, 686 n.5 (1980); *Ernst & Ernst*, 425 U.S. at 194 n.12. As long as the Court determines that recklessness is insufficient to establish *scienter* for aiding and abetting liability under the statute, it need not reach the issue of whether recklessness suffices to establish the requisite *scienter* for a primary violation. A finding by this Court that recklessness is sufficient to show *scienter* for aiding and abetting, on the other hand, would necessarily require the Court to address the sufficiency of recklessness for proving a primary violation.

<sup>16</sup> These elements are essentially derived from the Restatement (Second) of Torts § 876(b) (1979), which establishes joint tortfeasor liability for anyone who substantially assists in the commission of a tort. See Bromberg & Lowenfels, *Aiding and Abetting Securities Fraud: A Critical Examination*, 52 Alb. L. Rev. 637, 647 (1988).

**A. The Lower Courts Have Improperly Relied Upon Common Law Tort Principles In Embracing A Recklessness Standard.**

The recklessness standard adopted by the lower courts, like the concept of aiding and abetting liability itself, is primarily derived from the common law of torts. Virtually every court that has considered the issue has held that recklessness is sufficient to establish *scienter* both for primary violations of Section 10(b) and for aiding and abetting under varying conditions.<sup>17</sup>

This Court's decisions in *Ernst & Ernst*, 425 U.S. at 197-202, and *Aaron v. SEC*, 446 U.S. 680, 689-95 (1980), however, make clear that, in determining the level of *scienter* necessary to prove a Section 10(b) offense, resort must be made to "the plain meaning of the language of § 10 (b)," the statute's legislative history, and "the structure of the civil liability provisions in the 1933 and 1934 Acts." *Aaron*, 446 U.S. at 690. Reliance on these principles of statutory construction led the Court in *Aaron* to conclude that *scienter* is a necessary element in Section 10(b) injunctive proceedings brought by the SEC, even though the common law analogues of fraud do not require a showing of *scienter* in cases where injunctive relief is sought. *Id.* at 694-95. See also *Blue Chip Stamps*, 421 U.S. at 744-45 (classic tort law "light years away from" modern Section 10(b) action). To the extent that reference to the text and scheme of Section 10(b) is inconclusive, the Court has further instructed that it will look "to policy reasons for deciding where the outer limits of the right should lie." *Virginia Bankshares*, 111 S. Ct. at 2764 (citing *Blue Chip Stamps*, 421 U.S. at 737).

<sup>17</sup> See Johnson, *Liability for Reckless Misrepresentations and Omissions under Section 10(b) of the Securities Exchange Act of 1934*, 59 Cin. L. Rev. 667, 674 n.22 (1991) (collecting cases and relevant law review articles and treatises).

**B. This Court Should Adopt Stringent *Scienter* Standards Which Closely Tie The Alleged Aiding And Abetting Conduct To The Underlying Statutory Violation.**

The plain language of Section 10(b), its statutory scheme, and relevant policy considerations strongly support the adoption of stringent *scienter* requirements which closely tie aiding and abetting liability to the "manipulative and deceptive" practices proscribed by Congress. The common law-based recklessness standard urged by Respondents, in contrast, extends liability under Section 10(b) far beyond the statutory concern.

**1. The Language Of Section 10(b) Supports Heightened *Scienter* Requirements For Aiders And Abettors.**

In *Ernst & Ernst*, the Court held that the plain meaning of the terms "manipulative," "device," and "contrivance" in Section 10(b) evince an "unmistakable" congressional intent to proscribe only "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." 425 U.S. at 199 & nn. 19-20. Later, in *Santa Fe Indus.*, the Court reaffirmed that "[t]he language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception." 430 U.S. at 473.

The word "manipulative," the Court noted, is a term of art when used in connection with the securities markets and refers "generally to practices, such as wash sales, matched orders, or rigged prices, -that are intended to mislead investors by artificially affecting market activity." *Id.* at 476 (citations omitted). Although the Court had "[n]o doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices," *id.* at 477, the Court concluded that Congress would not have chosen this "term of art" if it intended to bring within the scope of Section 10(b) every type of fraud, breach of fiduciary duty, or other misconduct that might arise in the context of a securities trans-



action. Thus, the Court held that a complaint states a cause of action under Section 10(b) "only if the conduct alleged can be fairly viewed as 'manipulative or deceptive' within the meaning of the statute." *Id.* at 473-74.

A private cause of action for aiding and abetting would implicate, to a much greater degree, the Court's concerns with restricting liability under Section 10(b) to conduct expressly proscribed by Congress. By its very nature, aiding and abetting extends liability beyond a violation of the statute itself to reach conduct which otherwise would not be actionable. Aiding and abetting liability is thus divorced from the statutory language and, if not properly grounded, may be (and has been) extended to sweep in broad classes of conduct that Congress never intended to address in the statute. Just as this Court has not allowed Section 10(b) to be expanded to cover all conduct related in some way to a securities transaction, this Court should reject any standard of liability which allows such an expansion through the back door of aiding and abetting. By adopting stringent *scienter* requirements, this Court can require the necessary nexus between the "manipulative" and "deceptive" acts Congress intended to proscribe in Section 10(b) and the conduct giving rise to an independent claim of aiding and abetting.

First, because aiding and abetting liability is predicated on the conduct of a primary violator, a plaintiff should be required to show that the alleged aider and abettor had *actual knowledge* of the primary violation of Section 10(b). This knowledge requirement would properly limit aiding and abetting liability to those who knowingly involve themselves in the type of wrongful practices Congress intended to prohibit, thereby lessening the concerns that such involvement does not itself violate Section 10(b). Requiring fact-based allegations of actual knowledge of the underlying violation would also deter the now common practice by plaintiffs of naming virtually every participant in a securities transaction as an aider and abettor, no matter how remote their involvement in the alleged fraud. *See, e.g., Roberts v. Peat, Marwick,*

*Mitchell & Co.*, 857 F.2d 646 (9th Cir. 1988), *cert. denied*, 493 U.S. 1002 (1989).

Second, because the rendering of "substantial assistance" in the underlying violation is not, in and of itself, actionable under Section 10(b), a plaintiff should be required to show that the alleged aider and abettor *consciously intended* to assist the primary violator in the conduct prohibited by the statute. Adoption of this conscious intent requirement would limit aiding and abetting liability to conduct that is clearly connected to an actual violation of Section 10(b), and would deter suits based on more remote conduct, for which there is no evidence Congress ever intended to impose liability under the federal securities laws.

The actual knowledge and conscious intent standards urged by the Institute would permit recovery against aiders and abettors in appropriate cases, while limiting the expansion of liability under Section 10(b) to conduct that more closely resembles the "manipulative and deceptive" practices Congress intended to proscribe under the statute. The common law-based recklessness standard urged by Respondents, on the other hand, would extend (and has extended) Section 10(b) liability to conduct that cannot, in the words of this Court, "be fairly viewed as 'manipulative or deceptive' within the meaning of the statute." *Santa Fe Indus.*, 430 U.S. at 474.

Adoption of a recklessness standard by the lower courts has led to numerous extensions of Section 10(b) liability far beyond the conduct intended by Congress.<sup>18</sup> These

<sup>18</sup> *See, e.g., Admiralty Fund v. Hugh Johnson & Co.*, 677 F.2d 1301 (9th Cir. 1982) (extending aiding and abetting liability under recklessness standard to accounting firm for failure to uncover alleged backlog of inventory, even though firm had complied with generally accepted auditing standards which did not require accountants to audit or comment on such backlog); *Andreo v. Friedlander, Gaines, Cohen, Rosenthal & Rosenberg*, 660 F. Supp. 1362 (D. Conn. 1987) (extending aiding and abetting liability under recklessness standard to law firm for failure to uncover alleged omissions in offering memorandum, even though firm had only assisted in preparation of drafts and made no representations about offering);



cases, which have made accountants and other professionals virtual guarantors against the issuer's fraud, demonstrate the need for the more stringent *scienter* standards urged by the Institute.<sup>19</sup>

## **2. The Statutory Scheme Supports Heightened *Scienter* Requirements For Aiding And Abetting Liability.**

The statutory scheme also supports more stringent *scienter* requirements for aiders and abettors. Section 11(b) of the 1933 Act (15 U.S.C. § 77k(b)) provides an express private cause of action when a registration statement misrepresents or omits material facts. The issuer of the securities is strictly liable for any resulting damages. Professionals such as accountants who participated in the preparation of the registration statements, however, "are accorded a 'due diligence' defense." *Ernst & Ernst*, 425 U.S. at 208. Similarly, Section 15 of the 1933 Act (15 U.S.C. § 77o) and Section 20(a) of the 1934 Act (15 U.S.C. § 78t) impose secondary liability on "controlling persons," but provide a good faith defense to such liability. Section 11(e) of the 1933 Act (15 U.S.C. § 77k(e)) also authorizes the court to require a plaintiff bring-

*Mishkin v. Peat, Marwick, Mitchell & Co.*, 658 F. Supp. 271 (S.D.N.Y. 1987) (extending aiding and abetting liability under recklessness standard to accounting firm for failure to uncover issuer's alleged solvency problems during audit, even though plaintiff alleged no specific reliance on firm's audit report and conceded that firm had made no misrepresentations).

<sup>19</sup> In *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490 (7th Cir. 1986), *LHLC Corp. v. Cluett, Peabody & Co.*, 842 F.2d 928 (7th Cir.), cert. denied, 488 U.S. 926 (1988), and *Schlifke v. Seafirst Corp.*, 866 F.2d 935 (7th Cir. 1989), the Seventh Circuit held that, in addition to meeting the elements for aiding and abetting, an aider and abettor must have committed one of the "manipulative or deceptive" acts prohibited under Section 10(b) and Rule 10b-5 with the same degree of *scienter* required for primary liability. This approach demonstrates an attempt by the Seventh Circuit to construe the scope of liability for aiding and abetting under Section 10(b) in a manner more consistent with the express language of the statute and the congressional intent underlying it.

ing suit under Sections 11 or 15 to post a bond for costs, including attorneys' fees, and permits an award of costs under certain specified circumstances.

These provisions evince a clear intent by Congress to provide special procedural safeguards and defenses to secondary parties when imposing potential liability on them under the federal securities laws, whether on the basis of their relationship to the primary violator or on the basis of their own conduct in the securities transaction. In light of this statutory scheme, there is no reason to believe that Congress would not have provided similar safeguards had it determined to impose aiding and abetting liability on secondary parties under Section 10(b). The *scienter* standards urged by the Institute would provide such protections.

## **3. Relevant Policy Considerations Weigh In Favor Of Stringent *Scienter* Standards For Aiding And Abetting.**

Adoption of more stringent *scienter* standards will also serve important policy objectives. Those considerations are discussed at pages 17-19, *supra*.

These higher standards will also tend to promote greater clarity, consistency, and coherence in the application of aiding and abetting liability under Section 10(b). See *Musick, Peeler*, 113 S. Ct. at 2090. As described by one commentator:

[T]he courts have been less than precise in defining what exactly constitutes a reckless misrepresentation. That imprecision has resulted in ad hoc, if not arbitrary, recklessness determinations. . . . [T]he result is that actual and potential parties to Section 10(b) and Rule 10b-5 actions cannot predict with any degree of certainty how a trier of fact will characterize challenged conduct and thus whether it may serve as the basis for liability.

Johnson, *Liability for Reckless Misrepresentations and Omissions under Section 10(b) of the Securities Exchange Act of 1934*, 59 Cin. L. Rev. 667, 674-75 (1991) (citing representative cases).

The mischief these varying recklessness standards have wrought in Section 10(b) cases is evidenced by the facts here. The Tenth Circuit held that recklessness is sufficient to show *scienter* for aiding and abetting, even in the absence of a duty to disclose or to act, where the defendant has engaged in "affirmative acts" which assisted the primary violation of Section 10(b). This holding conflicts with the standards adopted by the Second and Fourth Circuits, which hold that recklessness is insufficient to show *scienter* absent a duty to disclose. See *Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990); *Schatz v. Rosenberg*, 943 F.2d 485, 496 (4th Cir. 1991), *cert. denied*, 112 S. Ct. 1475 (1992).

In further contrast, the Fifth, Eighth, and Eleventh Circuits have adopted a "sliding scale" approach, under which the requisite degree of *scienter* varies depending on whether the defendant owes a duty to disclose and on the nature of the defendant's conduct. See, e.g., *Woodward v. Metro Bank*, 522 F.2d 84, 95-97 (5th Cir. 1975); *Akin v. Q-L Invs., Inc.*, 959 F.2d 521, 526 (5th Cir. 1992) (following *Woodward* but criticizing its standard as "mushy and difficult to apply"); *Metge v. Baehler*, 762 F.2d 621, 624-25 (8th Cir. 1985), *cert. denied*, 474 U.S. 1057 and 474 U.S. 1072 (1986); *Schneberger v. Wheeler*, 859 F.2d 1477, 1480-81 (11th Cir. 1988), *cert. denied*, 490 U.S. 1091 (1989).

By requiring actual knowledge of the underlying violation and a conscious intent to assist in its achievement, as the Institute proposes, this Court will bring much needed guidance to accountants and others with respect to the scope of their potential liability for aiding and abetting under Section 10(b). These standards are more likely to be uniformly and objectively applied by the courts, and to prevent the type of "ad hoc, if not arbitrary, recklessness determinations" that have plagued this area of jurisprudence. Johnson, *Liability for Reckless Misrepresentations*, 59 Cin. L. Rev. at 674.

Heightened *scienter* requirements will also separate colorable aiding and abetting cases from class action strike

suits and other vexatious litigation in the type of "readily demonstrable manner" embraced by this Court in *Blue Chip Stamps*, 421 U.S. at 743. In explaining the need to adhere to stringent standing requirements in Section 10(b) cases, the Court expressed practical concerns in *Blue Chip Stamps* that are directly relevant here:

Obviously there is no general legal principle that courts in fashioning substantive law should do so in a manner which makes it easier, rather than more difficult, for a defendant to obtain a summary judgment. But in this type of litigation, where the mere existence of an unresolved lawsuit has settlement value . . . because of the threat of extensive discovery and disruption of normal business activities which may accompany a lawsuit which is groundless in any event, but cannot be proved so before trial, such a factor is not to be totally dismissed.

*Id.* at 742-43.

The Institute has previously recounted the dramatic increase in defense costs and resulting disruption of services that aiding and abetting liability has caused to the accounting profession, even though the vast majority of cases have not been meritorious. The knowledge and conscious intent standards urged by the Institute will raise the pleading and proof requirements in aiding and abetting cases, thereby increasing the likelihood that actions with very little chance of success at trial will be resolved by dismissal or summary judgment. These more stringent standards also may deter frivolous nuisance suits from ever being filed. Should this Court conclude that a private cause of action for aiding and abetting is implied in Section 10(b), therefore, these *scienter* requirements will be critically important in ensuring that the resulting expansion of liability under the statute does not "ultimately result in more harm than good." *Blue Chip Stamps*, at 747-48.



**C. In All Events, Recklessness Should Only Suffice To Prove *Scienter* Where There Is A Well Recognized, Clearly Defined Duty To Speak Or Act.**

If this Court were to allow recklessness to suffice to prove *scienter* of an aider and abettor under Section 10(b), the Court should follow the majority of the circuits by strictly limiting the application of such a standard to cases where the aider and abettor has a well recognized, clearly defined duty to speak or act.

**CONCLUSION**

For the foregoing reasons, the Institute respectfully requests that this Court hold that there is no implied private cause of action for aiding and abetting violations of Section 10(b) and Rule 10b-5 or, to the extent this Court recognizes such a cause of action, that a showing of actual knowledge of the underlying violation and a conscious intent to assist substantially in its achievement be required to establish *scienter* for aiding and abetting liability.

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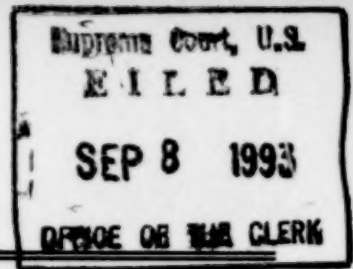
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Dated: July 30, 1993



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No. 92-854



In The  
**Supreme Court of the United States**  
October Term, 1992

— ♦ —  
CENTRAL BANK OF DENVER, N.A.,  
*Petitioner,*  
vs.

FIRST INTERSTATE BANK OF DENVER, N.A. and  
JACK K. NABER,  
*Respondents.*

— ♦ —  
On Writ Of Certiorari To The  
United States Court Of Appeals  
For The Tenth Circuit  
— ♦ —

BRIEF OF AMICUS CURIAE TRIAL LAWYERS  
FOR PUBLIC JUSTICE, P.C. AND UNITED STATES  
PUBLIC INTEREST RESEARCH GROUP IN  
SUPPORT OF RESPONDENTS  
— ♦ —

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## **QUESTIONS PRESENTED**

1. Whether there is a private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5.

2. Whether recklessness satisfies the scienter requirement for aiding and abetting.

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No. 92-854

In The  
**Supreme Court of the United States**  
 October Term, 1992

CENTRAL BANK OF DENVER, N.A.,

Petitioner,

vs.

FIRST INTERSTATE BANK OF DENVER, N.A. and  
 JACK K. NABER,

Respondents.

On Writ Of Certiorari To The  
 United States Court Of Appeals  
 For The Tenth Circuit

**BRIEF OF AMICUS CURIAE TRIAL LAWYERS  
 FOR PUBLIC JUSTICE, P.C. AND UNITED STATES  
 PUBLIC INTEREST RESEARCH GROUP IN  
 SUPPORT OF RESPONDENTS**

**I. INTRODUCTION AND INTEREST OF AMICUS  
 CURIAE<sup>1</sup>**

Trial Lawyers for Public Justice, P.C. (TLPJ) and United States Public Interest Research Group (USPIRG) are, respectively, a public interest law firm and a consumer advocacy organization which represent victims of fraud and misconduct. USPIRG is the national lobbying office for state Public Interest Research Groups (PIRGs) located in 31 states. State PIRGs are non-profit, non-

<sup>1</sup> This *amicus curiae* brief is filed pursuant to consent letters provided by counsel for Petitioner and Respondents.



partisan research and advocacy organizations with more than one million members.

The anti-fraud provisions of the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act) and rules and regulations promulgated thereunder by the Securities and Exchange Commission (SEC) are among the few effective remedies available to victims of fraud. TLPJ and USPIRG advocate continued recognition that the private right of action under § 10(b) of the Exchange Act and SEC Rule 10b-5 encompass aiding and abetting liability. This result is consistent with the Exchange Act's statutory language, construction and public policy which compelled its enactment and motivates its interpretation. Further, TLPJ and USPIRG believe that *recklessness* is the appropriate level of scienter for aiding and abetting liability and that the decision of the court below should be affirmed.<sup>2</sup>

## II. ARGUMENT

### A. Recognition Of Aiding And Abetting Liability Is Consistent With The Language Of § 10(b) And Rule 10b-5, Which Were Designed To Protect Investors And Deter Securities Fraud

"The starting point in every case involving construction of a statute is the language itself."<sup>3</sup> Section 10(b) and Rule 10b-5 state that it is "unlawful" for "any person" to engage in deceptive or manipulative acts or practices.<sup>4</sup> A violation of either provision is a

<sup>2</sup> The decision of the court below is reported as *First Interstate Bank of Denver, N.A. v. Pring*, 969 F.2d 891 (10th Cir. 1992), cert. granted sub nom. *Central Bank of Denver, N.A. v. First Interstate Bank, N.A.*, 113 S. Ct. 2927 (1993).

<sup>3</sup> *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976) (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring)).

<sup>4</sup> Section 10(b) makes it "unlawful for any person" to use or employ "any manipulative or deceptive device or contrivance"

crime<sup>5</sup> and aider and abettor liability is recognized under the common law of tort<sup>6</sup> and federal criminal law,<sup>7</sup> where

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in connection with the purchase or sale of any security and empowers the SEC to prescribe necessary and appropriate rules and regulations "in the public interest or for the protection of investors." 15 U.S.C. § 78j(b) (emphasis added). Rule 10b-5 makes it "unlawful for any person" to "employ any device, scheme, or artifice to defraud," make misleading representations or omissions, or "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person" in connection with the purchase or sale of any security. 17 C.F.R. § 240.10b-5 (emphasis added). Taken together, "[t]he sweeping words of § 10(b) and Rule 10b-5 ban manipulation, deception, or fraud in the purchase or sale of securities. '[A]ny person' who engages in such activity merits condemnation under the statute and the rule." *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 113 S. Ct. 2085, 2094 (1993) (Thomas, Blackmun and O'Connor, JJ., dissenting).

<sup>5</sup> See 15 U.S.C. § 78ff (criminal liability for violations of securities laws); *United States v. Chiarella*, 588 F.2d 1358, 1368 n.16 (2d Cir. 1978) ("It is well-established that, except for issues of intent and burden of proof, criminal and civil liability under the securities laws are coextensive."), rev'd on other grounds, 445 U.S. 222 (1980).

<sup>6</sup> The *Restatement (Second) of Torts* § 876(b) (1979) imposes liability for harm to a third party if the person "knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself. . . ." In civil damage actions, the courts created the aiding and abetting cause of action largely by analogy to tort theories. See, e.g., *Brennan v. Midwestern Life Ins. Co.*, 259 F. Supp. 673, 680 (N.D. Ind. 1966) (noting that the *Restatement* principles "surely best fulfill the purposes of the [Exchange Act]"), aff'd, 417 F.2d 147 (7th Cir. 1969), cert. denied, 397 U.S. 989 (1970); see also *Halberstam v. Welch*, 705 F.2d 472, 477-78, 481-86 (D.C. Cir. 1983).

<sup>7</sup> 18 U.S.C. § 2(a) provides that "[w]hoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal."

the roots of the § 10(b) aiding and abetting cause of action lie.<sup>8</sup> Under 18 U.S.C. § 2(a), aiding and abetting a violation of § 10(b) is a violation of § 10(b). Moreover, aiding and abetting securities fraud is precisely the kind of deceptive practice which § 10(b) was designed to prohibit.<sup>9</sup>

This construction is consistent with § 10(b)'s purpose to protect investors from fraudulent practices in the

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See *United States v. Tejada*, 956 F.2d 1256, 1265 (2d Cir.) (to convict a defendant as an aider and abettor, government need show only " 'that [a defendant] in some sort associate[d] himself with the venture, that he participate[d] in it as in something that he wish[ed] to bring about, that he [sought] by his action to make it succeed'"; conviction may be upheld "even if a defendant did not participate 'in every phase of the criminal venture,' or have a 'stake in the outcome of the illegal venture.' ") (citations omitted), *cert. denied*, 113 S. Ct. 334 (1992); see also *Nye & Nissen v. United States*, 336 U.S. 613, 619 (1949). Federal criminal aiding and abetting liability was codified 25 years before the Exchange Act was enacted, see Act of Mar. 4, 1909, ch. 321, § 332, 35 Stat. 1152 (formerly 18 U.S.C. § 550).

<sup>8</sup> See *SEC v. Seaboard Corp.*, 677 F.2d 1301, 1311 (9th Cir. 1982) ("Tort and criminal theories have supported the implication of aider and abettor . . . liability."); accord *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1127 (5th Cir. 1988), *vacated in part on other grounds*, 492 U.S. 918 (1989); *IIT v. Cornfeld*, 619 F.2d 909, 922 & n.15 (2d Cir. 1980); see also 5 A. Jacobs, *The Impact of Rule 10b-5* § 2, at 1-5 (1980) ("Common law has an important bearing on [Rule] 10b-5 because courts discussing the Rule frequently analogized to tort concepts").

<sup>9</sup> As Petitioner concedes, see Brief for Pet. at 20, 18 U.S.C. § 2(a) reaches aiders and abettors of criminal violations of the securities laws. See *United States v. Kessi*, 868 F.2d 1097, 1103 (9th Cir. 1989) (affirming defendant's conviction for aiding and abetting § 10(b) violations); *United States v. Re*, 336 F.2d 306, 318 (2d Cir. 1964) (same), *cert. denied*, 379 U.S. 904 (1964); Bromberg & Lowenfels, *Aiding and Abetting Securities Fraud: A Critical Examination*, 52 Alb. L. Rev. 637, 766 (1988).

securities markets<sup>10</sup> and serve as "a comprehensive anti-fraud provision operating even when more specific laws have no application."<sup>11</sup> Congress' aim "in enacting the [Exchange] Act was not confined solely to compensating defrauded investors"; rather, "Congress intended to deter fraud and manipulative practices in the securities markets, and to ensure full disclosure of information material to invest[ors]."<sup>12</sup> Rules facilitating § 10(b) litigation "support[] the congressional policy embodied in the [Exchange] Act" of combating all forms of securities fraud.<sup>13</sup> Although Congress gave the SEC primary enforcement responsibility, private suits constitute "an essential tool for enforcement of the [Exchange] Act's requirements"<sup>14</sup> and are "a necessary supplement to

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<sup>10</sup> See *Basic, Inc. v. Levinson*, 485 U.S. 224, 230 (1988) ("The [Exchange] Act was designed to protect investors against manipulation of stock prices.") (citing S. Rep. No. 792, 73d Cong., 2d Sess. 1-5 (1934)).

<sup>11</sup> *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773, 2789 (1991) (Kennedy and O'Connor, JJ., dissenting); see also *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386 (1983) (referring to "the broad proscription against fraud in § 10(b)").

<sup>12</sup> *Randall v. Loftsgaarden*, 478 U.S. 647, 664 (1986) (emphasis added; citations omitted); accord *Musick, Peeler & Garrett*, 113 S. Ct. at 2090; see also *Herman & MacLean v. Huddleston*, 459 U.S. at 386-87 (primary policy in Exchange Act is the punishment and deterrence of securities violations).

<sup>13</sup> *Basic, Inc. v. Levinson*, 485 U.S. at 245.

<sup>14</sup> *Id.* at 231; see also Frankel, *Implied Rights of Action*, 67 Va. L. Rev. 553, 556 (1981) (primary purpose behind implied remedies in the securities field has been to deter fraudulent conduct through "an extension of SEC action").



[SEC] action,' "<sup>15</sup> as the SEC has repeatedly acknowledged.<sup>16</sup>

Aiding and abetting liability is consistent with public policy underlying the federal securities laws, which were enacted in the wake of the Great Depression to prevent a repeat of the 1929 stock market crash<sup>17</sup> by correcting inadequacies in the information provided by securities issuers to the investing public, deterring fraud and manipulation and restoring confidence in the securities markets,<sup>18</sup> necessary steps suggested by President Roosevelt.<sup>19</sup> The Securities Act and the Exchange Act were

<sup>15</sup> *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (quoting *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964)).

<sup>16</sup> See Ruder, *The Development of Legal Doctrine Through Amicus Participation: The SEC Experience*, 1989 Wis. L. Rev. 1167, 1168 (observing, as former SEC chairman, that "private securities litigation plays an essential role in federal securities regulation"); see also *Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations for 1990: Hearings Before a Subcomm. of the House Comm. on Appropriations*, 101st Cong., 1st Sess., pt. 6, at 208-09 (1989) (Statement of SEC chairman Ruder reporting that investor complaints, "which have increased significantly in recent years . . . are a traditional indicator of potential fraud. In 1987, the [SEC] received over 40,000 complaints and inquiries from investors, over 230% the number received in 1982.").

<sup>17</sup> See *United States v. Naftalin*, 441 U.S. 768, 775 (1979); *Ernst & Ernst v. Hochfelder*, 425 U.S. at 194.

<sup>18</sup> See 77 Cong. Rec. 2914 (1933) (remarks of Rep. Greenwood), reprinted in 1 J. Ellenberger & E. Mahar, *Legislative History of the Securities Act of 1933 and the Securities Exchange Act of 1934*, Item 7 (1973) (*Legislative History*); 77 Cong. Rec. 2939-40 (1934) (remarks of Rep. Koppleman), reprinted in 1 *Legislative History*, Item 7.

<sup>19</sup> In a special message to Congress, President Roosevelt called attention to the fragile state of financial institutions, stressing the need to deter securities fraud. He stated that secu-

enacted to combat securities fraud because state law was inadequate<sup>20</sup> to remedy the absence of business ethics on Wall Street.<sup>21</sup>

Professionals who seek to "reform" the securities laws and obtain immunity from liability for fraud and manipulation are direct descendants of critics in the 1930s who sought to repeal or modify the Securities Act and the Exchange Act, arguing that the legislation was so "draconian" that it would "dry up the nation's underwriting business and that 'grass would grow on Wall Street.'" <sup>22</sup>

rities legislation "should give impetus to honest dealing in securities and thereby bring back public confidence," and observed that "the public in the past has sustained severe losses through practices neither ethical nor honest on the part of many persons and corporations selling securities." 77 Cong. Rec. 937 (1933), reprinted in 1 *Legislative History*, Item 3.

<sup>20</sup> See 77 Cong. Rec. 3801 (1933) (remarks of Sen. Fletcher: Securities Act is "designed to protect the public from financial racketeering of . . . investment bankers . . ."); 77 Cong. Rec. 2914 (1933), reprinted in 1 *Legislative History*, Item 7 (remarks of Rep. Mapes: "[M]any of the leading bankers in the country no longer have the old-time sense of ethics or [pay] attention to the strict detail of honest business like the bankers of a former day. . . . The sale of . . . securities has reached a point where it is a scandal and a gigantic racket in America, and the Federal Government is the agency to stop it.").

<sup>21</sup> See *United States v. Naftalin*, 441 U.S. at 775-76; *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186-87 (1963); 77 Cong. Rec. 2925 (1933) (remarks of Rep. Kelly: "honest and legitimate industry . . . has been . . . made the victim of greedy and ruthless investment bankers"), reprinted in 1 *Legislative History*, Item 7; R. Jennings & H. Marsh, *Securities Regulation* 23 (5th ed. 1982) (*Securities Regulation*) (same).

<sup>22</sup> D. Ratner, *Securities Regulation* § 11, at 80 (2d ed. 1982). Justice Felix Frankfurter, then a professor and one of the leading spokesmen for the Securities Act, wrote that "[t]he leading financial law firms who have been systematically carrying on a campaign against [the Securities Act] have been seeking - now



These statutes targeted errant professionals, who were properly held responsible for the celebrated excesses of the 1920s,<sup>23</sup> and they encountered both open and undercover resistance.<sup>24</sup> In the end, Congress passed President

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that they and their financial clients have come out of their storm cellar of fear – not to improve but to chloroform the Act. They evidently assume that the public is unaware of the sources of the issues that represent the boldest abuses of fiduciary responsibility. . . .” J. Seligman, *The Transformation of Wall Street* 79 (1983) (*Transformation*) (quoting letter from Felix Frankfurter to Henry Stimson (Dec. 19, 1933)).

<sup>23</sup> Professor James Landis, the leading historian of the federal securities laws, has written that the Securities Act “naturally had its beginnings in the high financing of the Twenties that was followed by the market crash of 1929” and the “spectacularly illuminating investigation of the nature of this financing” undertaken by the Senate Banking and Currency Committee under the direction of counsel Ferdinand D. Pecora. “The Committee spread on the record more than the peccadillos of groups of men involved in the issuance and marketing of securities. It indicted a system as a whole that had failed miserably in imposing those essential fiduciary standards that should govern persons whose function it was to handle other people’s money. Investment bankers, brokers and dealers, corporate directors, accountants, all found themselves the subject of criticism so severe that the American public lost much of its faith in professions that had theretofore been regarded with respect that had approached awe.” Landis, *The Legislative History of the Securities Act of 1933*, 28 Geo. Wash. L. Rev. 29, 30 (1959) (*Securities Act*).

<sup>24</sup> Richard Whitney, president of the New York Stock Exchange, led the well-supported fight against securities regulation by the Government. He viewed such legislation as indirectly constituting a nationalization of business, which might result in a freezing of the stock exchange. See J. Seligman, *Transformation*, at 90. In addition, George May of Price Waterhouse & Co. was “opposed to . . . requirements for independent accountants.” Landis, *Securities Act*, 28 Geo. Wash. L. Rev. at 35 n.12.

Roosevelt’s legislation, including the Exchange Act, which entrusted authority over the market to the SEC.<sup>25</sup>

Abuses of the securities markets which led to enactment of these statutes have not disappeared with the passage of time,<sup>26</sup> and the Exchange Act cannot be subverted to provide errant professionals with a safe haven from primary or secondary liability to defrauded investors. For more than forty years, the federal courts have held that recognition of a private right of action for aiding and abetting securities fraud is necessary<sup>27</sup> if

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<sup>25</sup> See Note, “Controlling” Securities Fraud: Proposed Liability Standards for Controlling Persons Under the 1933 and 1934 Securities Acts, 72 Minn. L. Rev. 930, 930 n.2 (1988) (“The [Exchange] Act was adopted to regulate the securities markets, to provide a disclosure method to the people buying and selling securities, to create remedies for fraud, and to control the amount of the nation’s credit being put into the securities market.”) (citation omitted).

<sup>26</sup> Those who seek to abolish aiding and abetting liability distort the meaning of Congressional inaction more than three decades ago, see Brief for Pet. at 20-22; Brief *Amicus Curiae* of the Sec. Indus. Ass’n at 15-16, ignoring a 1983 Congressional report which, prior to passage of the Insider Trading Sanctions Act of 1984, Pub. L. 98-376, expressly endorsed “the judicial application of aiding and abetting liability to achieve the remedial purposes of the securities laws.” H.R. Rep. No. 355, 98th Cong., 1st Sess. at 10 (1983), reprinted in 1984 U.S.C.C.A.N. 2274, 2283.

<sup>27</sup> Petitioner’s *amici* improperly refer to aiding and abetting § 10(b) violations as a “new” cause of action, see, e.g., Brief *Amicus Curiae* of the Sec. Indus. Ass’n at 4, 10 and 17, ignoring the fact that aiding and abetting liability does not create a separate offense, see *Ruthenberg v. United States*, 245 U.S. 478, 481, 483 (1918); *United States v. Sellers*, 871 F.2d 1019, 1022 (11th Cir. 1989), the wealth of precedent recognizing such liability under the Exchange Act. See nn. 29-34, *infra*. The aiding and abetting cause of action repeatedly recognized by the federal courts is no more “new” than the § 10(b) defendant’s claim for contribution reaffirmed by this Court in *Musick, Peeler & Garrett*, 113 S. Ct. at 2091.

defrauded investors are to be made whole and fraud and manipulation are to be deterred. This case provides no basis to change well-settled law.

### B. Recognition Of A Private Right Of Action For Aiding And Abetting Promotes The Essential Public Interests Underlying The Exchange Act

Although this Court has twice reserved decision on aiding and abetting liability,<sup>28</sup> it should not ignore the federal courts' repeated recognition of this private right of action. Numerous early decisions recognized aiding and abetting<sup>29</sup> liability,<sup>30</sup> while each circuit court has

<sup>28</sup> In *Ernst & Ernst v. Hochfelder*, 425 U.S. at 191-92 n.7, this Court stated that "[i]n view of our holding that an intent to deceive, manipulate, or defraud is required for civil liability under § 10(b) and Rule 10b-5, we need not consider whether civil liability for aiding and abetting is appropriate under the section and the Rule, nor the elements necessary to establish such a cause of action." See also *Herman & MacLean v. Huddleston*, 459 U.S. at 379 n.5.

<sup>29</sup> See, e.g., *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. at 676-81 (issuer knowingly and purposely encouraged an artificial build-up in the market for its stock by failing to report improper activities of broker-dealer firm, which failed to deliver issuer's stock to purchasers); *SEC v. American Stock Exchange*, 217 F. Supp. 21, 28 (S.D. N.Y. 1962) (holding claims alleging that stock exchange and its members aided and abetted an illegal distribution of stock "by failing to take any disciplinary action" against brokers who "were well known to have been engaged in abusive conduct" as well as allegations that other defendants, including principal violators, "aided and abetted" the distribution); *Fry v. Schumacher*, 83 F. Supp. 476, 478 (E.D. Pa. 1950) (refusing to dismiss claim against brokers who had "aided and abetted" principal violators to write a letter which was an "integral part of the plan to defraud").

<sup>30</sup> Even before the implication of a private right of action under § 10(b) was recognized in *Kaplan v. Gypsum Co.*, 69 F.

recognized a private right of action for aiding and abetting under § 10(b) and Rule 10b-5.<sup>31</sup> This unanimous

Supp. 512, 514 (E.D. Pa. 1946), liability for aiding and abetting § 10(b) violations was employed in SEC enforcement actions. See Note, *A Complicity-Doctrine Approach to Section 10(b) Aiding and Abetting Civil Damages Actions*, 89 Colum. L. Rev. 180, 181 (1989). In *SEC v. Timetrust, Inc.*, 28 F. Supp. 34 (N.D. Cal. 1939), a suit seeking an injunction against principal violators and aiders and abettors, the district court upheld the SEC's complaint against the latter, citing the criminal code provisions making aiders and abettors responsible as principals and stating, "[N]o good reason appears why this same rule should not apply in an injunctive proceeding to restrain a violation of the same statute." *Id.* at 43. The court commented that "[t]here is ample authority to support the validity of a suit to enjoin persons who are aiding and abetting the commission of unlawful acts." *Id.* Petitioner's amici inexplicably ignore these early precedents. See Brief *Amicus Curiae* of the Sec. Indus. Ass'n at 7, 13.

<sup>31</sup> See, e.g., *Bloor v. Carro, Spanbock, Londin, Rodman & Fass*, 754 F.2d 57, 62 (2d Cir. 1985); *Hirsch v. Du Pont*, 553 F.2d 750, 758 (2d Cir. 1977); *Gould v. American-Hawaiian S.S. Co.*, 535 F.2d 761, 779-80 (3d Cir. 1976); *Abell v. Potomac Ins. Co.*, 858 F.2d at 1126 ("[O]ur [Fifth Circuit] cases impose [§ 10b-5] liability upon those who abet securities fraud.") (citing *Woodward v. Metro Bank*, 522 F.2d 84 (5th Cir. 1975)); *Herm v. Stafford*, 663 F.2d 669, 684 (6th Cir. 1981); *Ackerman v. Schwartz*, 947 F.2d 841, 845-46 (7th Cir. 1991); *FDIC v. First Interstate Bank, N.A.*, 885 F.2d 423, 429 (8th Cir. 1989); *SEC v. Seaboard Corp.*, 677 F.2d at 1311; *Kerbs v. Fall River Indus., Inc.*, 502 F.2d 731, 740 (10th Cir. 1974); *Investors Research Corp. v. SEC*, 628 F.2d 168, 178 (D.C. Cir.), cert. denied, 449 U.S. 919 (1980). See generally 4 A. Bromberg & L. Lowenfels, *Securities Fraud & Commodities Fraud*, § 8.5(610), at 8:505 (1991); Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification and Contribution*, 120 U. Pa. L. Rev. 597, 627-38 (1972) (*Multiple Defendants*).



precedent accords with the express language, statutory framework<sup>32</sup> and purposes of the Exchange Act:

[A] statute with a broad and remedial purpose such as the [Exchange Act] should not easily be rendered impotent to deal with new and unique situations within the scope of the evils intended to be eliminated. In the absence of a clear legislative expression to the contrary, the statute must be flexibly applied so as to implement its policies and purposes. In this regard, it cannot be said that civil liability for damages, so well established under the [Exchange Act], may never under any circumstances be imposed upon persons who do no more than aid and abet a violation of [§ 10(b)] and Rule 10b-5.<sup>33</sup>

<sup>32</sup> In *Musick, Peeler & Garrett*, this Court recognized that §§ 9 and 18 of the Exchange Act, 15 U.S.C. § 78i and § 78r, are particularly "close in structure, purpose and intent to the 10b-5 action," 113 S. Ct. at 2090 (citation omitted), and stated that interpreting a Rule 10b-5 action consistently with §§ 9 and 18 is important "to ensure the [10b-5] action does not conflict with Congress' own express rights of action, to promote clarity, consistency and coherence for those who rely upon or are subject to 10b-5 liability, and to effect Congress' objectives in enacting the securities laws." *Id.* (citations omitted). Contrary to Petitioner's assertion, see Brief for Pet. at 10; see also Brief of AICPA as *Amicus Curiae* at 4, 13-15, the SEC interprets § 9 to extend liability to aiders and abettors, see *In re Barry L. Lefko*, 47 S.E.C. 373 (Sept. 30, 1980), while accountants have been held liable as aiders and abettors under § 18, see, e.g., *In re Equity Funding Corp. of Amer. Sec. Litig.*, 416 F. Supp. 161, 190-91 (C.D. Cal. 1976).

<sup>33</sup> *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. at 680-81. See also Note, *Liability for Aiding and Abetting Violations of Rule 10b-5: The Recklessness Standard in Civil Damage Actions*, 62 Tex. L. Rev. 1087, 1093 (1984) (*Recklessness Standard*).

Common law aiding and abetting liability was well established when the Exchange Act was enacted,<sup>34</sup> and this Court has stated that Rule 10b-5 actions "are in part designed to add to the protections provided investors by the common law."<sup>35</sup> Thus, federal courts' unanimous recognition of aiding and abetting claims, developed over decades of litigation and securities fraud schemes of every sort, should not be ignored by this Court.<sup>36</sup>

<sup>34</sup> See *Ruder, Multiple Defendants*, 120 U. Pa. L. Rev. at 620; *Kuehnle, Secondary Liability Under the Federal Securities Laws - Aiding and Abetting, Conspiracy, Controlling Person, and Agency: Common-Law Principles and the Statutory Scheme*, 1988 J. Corp. L. 313, 316-17.

<sup>35</sup> *Basic, Inc. v. Levinson*, 485 U.S. at 244 n.22 (citing *Herman & MacLean v. Huddleston*, 459 U.S. at 388-89 ("[A]n important purpose of the federal securities statutes was to rectify perceived deficiencies in the available common-law protections. . . .")).

<sup>36</sup> Just this past Term, when this Court recognized a defendant's right to seek contribution in a Rule 10b-5 private action, Justice Kennedy stated that "[o]ur conclusion is consistent with the rule adopted by the vast majority of courts of appeals and district courts that have considered the question," observing that "[w]e consider this to be of particular importance because in the more than twenty years since a right to contribution was first recognized for 10b-5 defendants, neither the [SEC] nor the federal courts have suggested that the contribution right detracts from the effectiveness of the 10b-5 implied action or interferes with the effective operation of the securities laws." *Musick, Peeler & Garrett*, 113 S. Ct. at 2091 (citations omitted). This recent teaching is equally applicable here. See *Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1123 (7th Cir. 1990) (recognizing that "aider and abettor liability is rooted in 20+ years' precedent"), *cert. denied*, 111 S. Ct. 1317 (1991); *Ferrara & Sanger, Derivative Liability in Securities Law: Controlling Person Liability, Respondeat Superior, and Aiding and Abetting*, 40 Wash. & Lee L. Rev. 1007, 1023 (1983).



### C. The Recklessness Standard Of Scienter Should Govern Aiding And Abetting Liability

This Court has held that a finding of *scienter* – intent to deceive, manipulate, or defraud – is a prerequisite to § 10(b) liability, eliminating negligence as a possible basis for a finding of liability, but not deciding whether *recklessness* could be sufficient.<sup>37</sup> The circuit courts unanimously agree that *recklessness* satisfies the *scienter* requirement.<sup>38</sup> Given this precedent, common law recognition that *reckless* behavior supports fraud claims,<sup>39</sup> and

<sup>37</sup> In *Ernst & Ernst v. Hochfelder*, 425 U.S. at 194 n.12, this Court defined *scienter* as “a mental state embracing intent to deceive, manipulate, or defraud,” and adopted the view that the language of § 10(b), in particular the terms “manipulative,” “device” and “contrivance” revealed an unambiguous intent on the part of Congress to proscribe only “knowing or intentional practices.” *Id.* at 197-99; see also *Aaron v. SEC*, 446 U.S. 680, 690 (1980).

<sup>38</sup> See, e.g., *Cook v. Avien, Inc.*, 573 F.2d 685, 692 (1st Cir. 1978); *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 46 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978); *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 193 (3d Cir. 1981), *cert. denied*, 455 U.S. 938 (1982); *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 961-62 (5th Cir.) (en banc), *cert. denied*, 454 U.S. 965 (1981); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1024 (6th Cir. 1979); *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1044 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977); *Stokes v. Lokken*, 644 F.2d 779, 783 (8th Cir. 1981); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 1621 (1991); *Hackbart v. Holmes*, 675 F.2d 1114, 1117-18 (10th Cir. 1982); *Woods v. Barnett Bank*, 765 F.2d 1004, 1010 (11th Cir. 1985); *Dirks v. SEC*, 681 F.2d 824, 844 & n.27 (D.C. Cir. 1982), *rev'd on other grounds*, 463 U.S. 646 (1983). See also Note, *Recklessness Standard*, 62 Tex. L. Rev. at 1100-02.

<sup>39</sup> *Hochfelder* acknowledged that “[i]n certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act.” 425 U.S. at 194 n.12. At common law, *recklessness* sufficed to establish civil liability for fraud and deceit. See, e.g., *Cooper v. Schlesinger*, 111

the fact that *recklessness* suffices for *criminal* liability,<sup>40</sup> this standard suffices to prove aiding and abetting. Because

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U.S. 148, 155 (1884); cf. *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2759 (1991); see also *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d at 1044; *Derry v. Peek*, 14 App. Cas. 337, 374 (1889) (per Lord Herschell) (“[F]raud is proved when it is shewn that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) *recklessly*, careless whether it be true or false.”); Freeman & Crystal, *Scienter in Professional Liability Cases*, 42 S.C. L. Rev. 783, 788-93 (1991); W. Page Keeton, et al., *Prosser & Keeton on the Law of Torts*, § 107, at 741-42 (5th ed. 1984); *Restatement (2d) of Torts*, § 526, comment e (1977). *Sundstrand* stated that “[s]ince there is no hint in *Hochfelder* that the [Supreme] Court intended a radical departure from accepted Rule 10b-5 principles, it would be highly inappropriate to construe the Rule 10b-5 remedy to be more restrictive in substantive scope than its common law analogs.” 553 F.2d at 1044 (footnotes omitted).

<sup>40</sup> See 18 U.S.C. § 1341 (mail fraud); *United States v. Gay*, 967 F.2d 322, 326 (9th Cir.) (“We have repeatedly held that reckless indifference alone will support a mail fraud conviction.”) (citations omitted), *cert. denied*, 113 S. Ct. 359 (1992). Both lawyers and accountants have been found guilty of criminal violations under a *recklessness* culpability standard. See, e.g., *United States v. Frank*, 520 F.2d 1287 (2d Cir. 1975) (conviction of lawyer for conspiracy to violate securities laws in connection with public offering), *cert. denied*, 423 U.S. 1087 (1976); *United States v. Simon*, 425 F.2d 796 (2d Cir. 1969) (accountants convicted for issuing audit opinion in violation of mail fraud and false statement statute and securities laws), *cert. denied*, 397 U.S. 1006 (1970). Trial judges approve instructions that allow juries to infer willful and knowing criminal securities law violations based on defendant auditors’ “reckless deliberate indifference to or disregard for truth or falsity.” *United States v. Weiner*, 578 F.2d 757, 786, 787 (9th Cir.), *cert. denied*, 439 U.S. 981 (1978); *United States v. Natelli*, 527 F.2d 311, 322-23 (2d Cir. 1975), *cert. denied*, 425 U.S. 934 (1976).

this Court should interpret § 10(b) to protect investors,<sup>41</sup> uniform application of the recklessness standard<sup>42</sup> would acknowledge pivotal roles played by lawyers, accountants, investment bankers and brokers in effective implementation of the securities laws<sup>43</sup> and ensure at least

<sup>41</sup> See *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972); Aldave, "Neither Unusual nor Unfortunate": The Overlap of Rule 10b-5 with the Express Liability Sections of the Securities Acts, 60 Tex. L. Rev. 714, 755 (1982).

<sup>42</sup> "Nothing in *Hochfelder* or in any other Supreme Court decision suggests that the scienter requirement should differ for primary violators and aiders and abettors." Note, *Recklessness Standard*, 62 Tex. L. Rev. at 1111 (footnote omitted). Indeed, in *United States v. Feola*, 420 U.S. 684, 686-88 (1975), this Court rejected the notion that connivers enjoy a heightened intent standard compared to primary wrongdoers.

<sup>43</sup> See *In re American Continental Corp./Lincoln Sav. & Loan Sec. Litig.*, 794 F. Supp. 1424, 1441-54 (D. Ariz. 1992) (ACC/Lincoln) (detailing roles played by accounting firms, law firms and consulting firms in multi-billion dollar fraudulent scheme to defraud over 20,000 elderly investors); *Mishkin v. Peat, Marwick, Mitchell & Co.*, 658 F. Supp. 271, 273-75 (S.D.N.Y. 1987) (detailing integral role played by accountants in securities regulatory process); Note, *Establishment of Liability for Aiding and Abetting Fraud Under Rule 10b-5 and the Common Law*, 25 UCLA L. Rev. 862, 883-84 (1978) (same).

minimal diligence by such participants,<sup>44</sup> thus enhancing protection afforded investors.<sup>45</sup>

**D. Given The Prevalence Of Fraud And White-Collar Crime, This Court Should Be Loath To Restrict Remedies Available To Innocent Victims**

Our societal landscape is littered with the wreckage of costly failures of financial institutions, many of which have been caused by fraudulent and criminal activity and the costs of which are incalculable.<sup>46</sup> The past three

<sup>44</sup> Accountants themselves do not dispute or disclaim their obligation to third party users of audit opinions: "A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting profession's public consists of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on certified public accountants." 2 AICPA, *Professional Standards*, § 53.01 (CCH 1988).

<sup>45</sup> Holding errant professionals liable for recklessness furthers the underlying goal of the securities laws, which is to encourage investment. An investor's willingness to invest is largely dependent on his or her trust and confidence that capital and proceeds will not be abused. See Langevoort, *Fraud and Deception by Securities Professionals*, 61 Tex. L. Rev. 1247, 1275 (1983). By requiring that experts and insiders at least avoid the extreme conduct proscribed by the recklessness standard, the securities laws enhance investor trust. Note, *Recklessness Standard*, 62 Tex. L. Rev. at 1113.

<sup>46</sup> The financial costs incurred by society as a result of fraudulent activity and so-called "white collar" crime are enormous. See generally J. Cotchett & S. Pizzo, *The Ethics Gap* (1991). In 1974, the U.S. Chamber of Commerce estimated the direct economic cost of fraud as \$41.78 billion annually. Chamber of Commerce of the U.S., *A Handbook on White Collar Crime: Everyone's Problem, Everyone's Loss* 6 (1974). A decade later, the Attor-



decades have witnessed numerous financial scandals resulting in multi-billion dollar losses to innocent investors (including stockholders, bondholders and depositors) in financial institutions and corporate entities for which errant professionals bear a large degree of responsibility.<sup>47</sup> These scandals include Bank of Credit and Commerce International (BCCI), whose worldwide criminality and resulting 1991 collapse and seizure by regulators caused one million depositors to lose \$8-10 billion,<sup>48</sup>

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ney General observed that white collar crime, principally fraud, costs nearly \$200 billion annually. 1985 Atty. Gen. Ann. Rep. 42; see also *White Collar Crime: Hearings Before the Senate Comm. on the Judiciary*, 99th Cong., 2d Sess., Parts I-III (1985). That now-dated annual loss figure is similar in dimensions to our drug problem, which is most often described as an epidemic. See *Drug Enforcement: Hearing on H.R. 526 Before Subcomm. on Crime of the House Comm. on the Judiciary*, 99th Cong., 2d Sess. (1986) (Remarks of Rep. Hughes: \$110 billion spent annually on drugs while lost productivity costs approximately \$60 billion).

<sup>47</sup> A recent report provides eleven case studies of litigation involving the so-called "Big Six" accounting firms (KPMG Peat Marwick, Ernst & Young, Coopers & Lybrand, Arthur Andersen, Deloitte & Touche and Price Waterhouse) illustrating flagrant deficiencies leading to large-scale failures and consumer losses. In just six of these examples, shareholders, investors, creditors and/or taxpayers lost more than \$10 billion: Benjamin Franklin Sav. Ass'n - \$976 million (Arthur Andersen); MiniScribe Corp. - \$20.5 million for bondholders alone (Coopers & Lybrand); CenTrust Sav. Bank - \$1.8 billion (Deloitte & Touche); Vernon Sav. & Loan Ass'n, Silverado Sav. & Loan Ass'n, Lincoln Sav. & Loan Ass'n and Western Sav. & Loan Ass'n - \$6.6 billion (Ernst & Young); Hill Finan. Sav. Ass'n - \$988 million (KPMG Peat Marwick); and United Bank of Arizona - \$338 million (Price Waterhouse). See Public Citizen/USPIRG, *Bad Audits . . . Not Deep Pockets: Illustrations of Failed Audits by the Big 6* 7-8 (1993).

<sup>48</sup> Depositors, including U.S. citizens and residents, were induced to place their money in the BCCI Banks, where it was used to finance illegal transactions, siphoned off to BCCI

and the celebrated downfall of Charles Keating's American Continental Corporation (ACC) and wholly-owned Lincoln Savings (Lincoln), whose 1989 bankruptcy and seizure by federal regulators cost taxpayers over \$2 billion.<sup>49</sup> Scandals also enveloped once-respectable financial

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insiders and affiliates, and lost forever when the Banks were seized by regulators. Because BCCI was headquartered in so-called "secrecy" jurisdictions where deposit insurance is virtually non-existent, defrauded depositors may recover only a fraction of their losses. BCCI pled guilty to state and federal criminal charges arising from its illegal conduct in the U.S. and agreed to forfeit over \$550 million in assets located here. Numerous professionals, including accounting firms (Price Waterhouse and Ernst & Young), allegedly aided and abetted BCCI in its lengthy effort to defraud depositors and deceive banking regulators, as detailed in the two-volume U.S. Senate investigative report, Subcommittee on Terrorism, Narcotics and International Operations, *The BCCI Affair: A Report to the Senate Comm. on Foreign Relations* (1992), and the report published by the General Accounting Office (GAO), *Foreign Bank - Initial Assessment of Certain BCCI Activities in the U.S.* (1992).

<sup>49</sup> The Federal Deposit Insurance Corporation (FDIC), Resolution Trust Corporation (RTC) and defrauded bondholders brought civil actions against Keating, insiders and professional advisers who assisted in carrying out an elaborate securities and bank fraud scheme. Keating utilized political influence to stave off regulatory censure and seizure of Lincoln by improperly influencing members of Congress (including the "Keating Five") and intimidating regulators while he peddled worthless junk bonds in thrift branch offices to elderly victims who thought they were purchasing government-insured bonds. The ACC/Lincoln class action, which targeted three of the "Big Six" accounting firms (Arthur Andersen, Arthur Young and Touche Ross) and three national law firms (Sidley & Austin, Kaye Scholer Fierman Hays & Handler, and Jones Day Reavis & Pogue) who aided and abetted Keating in violating federal and state securities laws, defrauding innocent investors and intimidating federal and state regulators resulted in settlements totaling \$250 million paid by errant professionals and, following a three-month jury trial, a jury verdict of \$3.3 billion against



institutions and financiers, such as Drexel Burnham Lambert and Michael Milken,<sup>50</sup> as well as other Wall Street investment banks and brokerage houses,<sup>51</sup> while fraud

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Keating and others. See M. Freudenheim, *U.S. Jury Awards \$3.3 Billion To Investors From Keating*, N.Y. Times, July 11, 1992, at 15. This salutary result in a Rule 23 securities fraud class action contradicts arguments regarding the merits of such litigation raised by errant professionals. See Brief *Amicus Curiae* of the Sec. Indus. Ass'n at 26; Brief of AICPA as *Amicus Curiae* at 28-29.

<sup>50</sup> Milken was indicted on 98 counts of RICO and criminal securities fraud, pled guilty to six felony charges (including conspiracy, securities fraud, mail fraud and filing false tax returns) and was sentenced to ten years' imprisonment. See "Junk Bond" Leader Is Indicted by U.S. in Criminal Action, N.Y. Times, Mar. 30, 1989, at A1, col. 6 (98-count indictment); SEC v. Milken, [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,200 (S.D.N.Y. Apr. 24, 1990) (settlement of civil enforcement action); *United States v. Milken*, 759 F. Supp. 109 (S.D.N.Y. 1990) (Fatico hearing); see also *In re The Drexel Burnham Lambert Group, Inc.*, No. 92-5032, 1993 U.S. App. LEXIS 12445, at \*3-\*4 (2d Cir. 1993) (detailing Milken's wrongdoing).

<sup>51</sup> The insider trading scandals which rocked Wall Street trapped E.F. Hutton, which acknowledged systemic criminal behavior, see *White Collar Crime (E.F. Hutton): Hearings Before the Senate Judiciary Committee*, 98th Cong., 2d Sess. 132 (1986) (Sen. Jos. R. Biden: "Where I come from that is called 'theft.'" Robert Foman, chairman of E. F. Hutton Group, Inc.: "It is probably not different"). Insider trading apparently continues unabated. A recent study published by the University of Michigan's School of Business Administration "shows that top executives at troubled, publicly traded companies often begin dumping large amounts of shares as much as two years before filing for corporate bankruptcy," while "during the two years leading up to a bankruptcy filing, shareholders lose on average 75% of their investments." W. Getler, *Insiders Often Dump Shares Long Before Concerns Enter Bankruptcy, Study Says*, Wall St. J., July 7, 1993, at A5, col. 1.

and criminality infected the savings and loan industry.<sup>52</sup> The costs to our society and resulting loss of investor confidence cannot be calculated.

If history teaches us anything,<sup>53</sup> the overwhelming presence of fraud in the securities markets leading to enactment of the Securities Act and the Exchange Act has

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<sup>52</sup> Numerous lawsuits have been brought by the RTC, creditors and innocent investors against owners, operators, insiders and professional advisers of thrift institutions which failed as a result of insider abuse, fraudulent transactions and excessive "direct" investments, including purchase of billions of dollars of "junk bonds" peddled by Drexel/Milken. See Note, *Insider Abuse and Criminal Misconduct in Financial Institutions: A Crisis?*, 64 Notre Dame L. Rev. 222 (1989). The GAO studied 184 FDIC-insured banks that closed in 1987 and found that 64% of the failed banks revealed insider abuse and 38% revealed insider fraud. *Examination and Supervision of Depository Institutions: Hearings Before the House Comm. on Banking, Finance and Urban Affairs*, 101st Cong., 1st Sess. 21 (1989). Other Government studies concluded that at least one-third of bank failures and three-quarters of thrift failures involved the criminal activity of insiders. See Office of Comptroller of Currency, *Bank Failure: An Evaluation of the Factors Contributing to the Failure of National Banks* 9 (1988).

<sup>53</sup> The pervasiveness of criminal and fraudulent activity, including professionals' fiduciary breaches, was noted more than 25 years ago. See President's Commission on Law Enforcement and Administration of Justice, *The Challenge of Crime in a Free Society* 33-34, 47-48 (1967) (*The Challenge of Crime*) ("Fraud is especially vicious when it attacks, as it so often does, the poor or those who live on the margin of poverty. Expensive nostrums for incurable diseases, home improvement frauds, frauds involving the sale or repair of cars and other criminal schemes creates losses which are not only sizeable in gross but are also significant and possibly devastating for individual victims."); H. Edelhertz, *The Nature, Impact and Prosecution of White-Collar Crime* 9 (1970) (white-collar crime has a "serious influence on the social fabric, and on the freedom of commercial and interpersonal transactions").

not abated; if anything, the crisis has deepened.<sup>54</sup> The recent abuse of the securities markets makes clear that elimination of aiding and abetting liability would be especially damaging to innocent victims of fraud. Recent financial scandals are noteworthy because of the integral role played by errant professionals who aided and abetted those wrongdoers whom Theodore Roosevelt once referred to as "the wealthy criminal class."<sup>55</sup>

Prosecutorial resources are inadequate to combat "white-collar" crime and fraud, primary wrongdoers are often insolvent or bankrupt when the fraud is discovered,<sup>56</sup> and state law remedies do not provide meaningful

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<sup>54</sup> The Chief Justice has stated that "[w]hite-collar crime is 'the most serious and all-pervasive crime problem in America today,' " *Braswell v. United States*, 487 U.S. 99, 115 n.9 (1988) (quoting Conyers, *Corporate and White-Collar Crime: A View by the Chairman of the House Subcommittee on Crime*, 17 Am. Crim. L. Rev. 287, 288 (1980)), adding that "[a]lthough this statement was made [by Representative Conyers] in 1980, there is no reason to think the problem has diminished in the meantime." *Id.*

<sup>55</sup> In March 1883, supporting a bill in the New York Assembly to limit the extortionate profits earned by robber barons from operation of the Manhattan Elevated Railroad, Roosevelt stated that "[t]hey are common thieves . . . they belong to that most dangerous of all classes, the wealthy criminal class." E. Morris, *The Rise of Theodore Roosevelt* 193 (Ballantine ed. 1979); see also H. M. Sullivan, *Our Times: The United States - America Finding Herself* 386 (1927).

<sup>56</sup> See Note, *Recklessness Standard*, 62 Tex. L. Rev. at 1088; R. Jennings & H. Marsh, *Securities Regulation*, at 1134. This was typified in the ACC/Lincoln case where Keating's profligate spending and Government enforcement/forfeiture proceedings had rendered him judgment-proof, his holding company (ACC) filed for bankruptcy, its wholly-owned thrift (Lincoln) was seized by regulators and ACC's insurance policies excluded coverage for investors' claims, see *Keating v. National Union Fire Ins. Co.*, No. 90-56265, 1993 U.S. App. LEXIS 12998 (9th Cir. 1993). Without securities fraud aiding and abetting claims against professionals who helped Keating cheat investors, his

remedies to victims of sophisticated financial frauds.<sup>57</sup> Thus, any decision impeding victims' rights against those who aid and abet § 10(b) violations would be inconsistent with express purposes of the Exchange Act.

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23,000 elderly victims, many of whom lost their life's savings, would have recovered *nothing*.

<sup>57</sup> The notion advanced by Petitioner's amici that common law fraud and negligent misrepresentation claims may be brought by defrauded investors against professionals, see Brief of AICPA at 19-20, is misplaced. See *Gaffin v. Teledyne, Inc.*, 611 A.2d 467, 474 (Del. 1992) ("A class action may not be maintained in a purely common law or equitable fraud case since individual questions of law or fact, particularly as to the element of justifiable reliance, will inevitably predominate over common questions of law or fact.") (footnote and citations omitted). In *Basic, Inc. v. Levinson*, 485 U.S. at 241-42, this Court quoted with approval the Third Circuit's decision in *Peil v. Speiser*, 806 F.2d 1154, 1160-61 (3d Cir. 1986), recognizing the fraud-on-the-market theory for § 10(b) claims. In *Peil*, however, the Third Circuit also stated: "While the fraud on the market theory is good law with respect to the Securities Acts, no state courts have adopted the theory, and thus direct reliance remains a requirement of a common law securities fraud claim." *Id.* at 1163 n.17. See also *Bily v. Arthur Young & Co.*, 3 Cal. 4th 370, 11 Cal. Rptr. 2d 51, 834 P.2d 745 (1992) (auditor can be held liable for negligence in conducting an audit of financial statements only to person or entity contracting for auditor's services); *Mirkin v. Wasserman*, 12 Cal. App. 4th 927, 278 Cal. Rptr. 729 (fraud-on-the-market theory inapplicable to investors' claims for fraud and negligent misrepresentation), *review granted*, 1991 Cal. LEXIS 2850, 282 Cal. Rptr. 840, 811 P.2d 1024 (1991).



**E. Because Errant Professionals Often Play An Integral Role In Schemes To Defraud Investors, They Should Not Be Absolved Of Aiding And Abetting Liability**

Recent complex financial schemes demonstrate that errant professionals often play an integral role<sup>58</sup> in their conception and execution.<sup>59</sup> Our nation's continuing bank and thrift crisis, which has already cost savers billions of dollars, was typified by a professional

<sup>58</sup> In contending that aiding and abetting tort liability is inapplicable, amici cite *Blue Chip Stamps*, where this Court found a unique fact situation in which the classic tort of fraud and deceit evolved was light years removed from the world of commercial transactions to which Rule 10(b) is applicable." 421 U.S. at 744-45. Brief of AICPA as Amici at 16. As Petitioner acknowledges, however, § 10(b) was intended to enable the SEC "to deal with new manipulative [or cunning] devices." *Hochfelder*, 425 U.S. at 203 (citation omitted). See Brief for Pet. at 14. Recent financial schemes demonstrate the multitude of innovative ways errant professionals have developed to aid and abet crooked financiers. See *ACC/Lincoln*, 794 F. Supp at 1441-54. This trend supports expansion of aiding and abetting liability, not its elimination.

<sup>59</sup> See Statement of Prof. Arthur R. Miller On H.R. 3185 Before the Subcomm. on Telecommunications and Finance, House Comm. on Energy and Commerce at 10 (Nov. 21, 1991) ("The perpetration of a complex financial fraud is impossible without the active assistance of professionals such as investment bankers, lawyers, and accountants who must be held accountable."). Contrary to the assertions of Petitioner's amici, there is no reasoned basis to conclude that professionals are "routinely sued for aiding and abetting" § 10(b) violations, see Brief of AICPA at 2; nor is there is any basis to conclude that securities fraud claims leveled against professionals lack merit, or that they have been compelled to pay settlements that are disproportionate to their liability, see *id.* at 17-19.

ethics by accountants, lawyers and other professionals.<sup>60</sup> Government agencies have been sharply critical of the accounting profession for its repeated failure to uncover widespread fraud in failing financial institutions,<sup>61</sup> as

<sup>60</sup> In assessing the causes of the thrift crisis, careful attention must be paid to critical roles played by professionals – attorneys, accountants, brokers, investment bankers, consultants and real estate appraisers – who abandoned their professional ethics to serve thrifts' operators. Crimes in thrifts "often required the cooperation of groups of people," including outside professional advisers, in what might be called a "chain of greed." The chains involved five kinds of professionals, in addition to the borrowers who benefitted from the questionable loans: "At the beginning of a transaction, real estate brokers masterminded the shaky deals. Crooked appraisers then inflated real estate values to make the deals work. Inside the institutions, an array of employees from loan officers hungry for a loan commission to the executives themselves participated in the fraud. At the conclusion of the deal, lawyers 'papered' the bogus transactions by drawing up the contracts, and accountants either looked the other way or neglected to scour the institutions' books too carefully." Harris, *The S&L Looters Who May Get Away*, Wall St. J., Feb. 12, 1990, at A12, col. 3.

<sup>61</sup> Running through the thrift crisis is the problem of fraudulent financial reporting. When such aberrant behavior occurs, widespread consequences result, sometimes causing a devastating ripple effect. See Nat'l Comm'n on Fraudulent Financial Reporting, *Report of the Nat'l Commission on Fraudulent Financial Reporting* 4 (1987). The GAO has excoriated the accounting profession – especially Ernst & Young – for its failing thrifts. See GAO, *CPA Audit Quality: Failures of CPA Audits to Identify and Report Significant Savings and Loan Problems* 1 (1989) (concluding that accountants followed improper auditing procedures in 6 out of 11 failed institutions they reviewed: "The latest audit reports for the 11 S&Ls before they failed showed combined positive net worth totaling approximately \$44 million. At the time of the S&Ls' failures, which ranged from 5 to 17 months after the date of the last audit reports, the 11 S&Ls had combined negative net worth totaling approximately \$1.5 billion.").



have federal Judges Royce Lamberth<sup>62</sup> and Stanley Sporkin.<sup>63</sup> Professionals' responsibility for the destruction of our financial institutions cannot be ignored and it highlights the intellectual bankruptcy of their demands for immunity.<sup>64</sup> Such wrongdoing is not a recent

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<sup>62</sup> Enforcing a subpoena issued by the Office of Thrift Supervision (OTS), which sought to compel Ernst & Young to turn over documents relating to its audit and accounting work on behalf of 23 failed thrift institutions, Judge Lamberth wrote that "[a]ccounting firms may have been responsible for many of the abuses which have led to this country's savings and loan crisis. In fact, OTS advised the court that approximately one-third of the 690 financial institutions that have failed were audited by Ernst & Young or its predecessor." *Director of OTS v. Ernst & Young*, 786 F. Supp. 46, 52 (D.D.C. 1992).

<sup>63</sup> Judge Sporkin highlighted the role played by professionals who aided and abetted the fraudulent operation of Keating's ACC/Lincoln enterprise:

Keating testified that he was so bent on doing the "right thing" that he surrounded himself with literally scores of accountants and lawyers to make sure all the transactions were legal. . . .

Where were these professionals, a number of whom are now asserting their rights under the Fifth Amendment, when these clearly improper transactions were being consummated?

Why didn't any of them speak up or disassociate themselves from the transactions?

Where also were the outside accountants and attorneys when these transactions were effectuated?

*Lincoln Sav. & Loan Ass'n v. Wall*, 743 F. Supp. 901, 919-20 (D.D.C. 1990).

<sup>64</sup> See Note, *Are the Accountants Liable? Auditor Liability in the Savings and Loan Crisis*, 25 Ind. L. Rev. 475, 486 (1991) (observing that from the beginning of the thrift crisis, some institutions were given "clean" audit opinions only to be declared insolvent shortly thereafter); France, *Savings & Loan Lawyers*, 77 A.B.A.J. 52 (May 1991) (critical roles were often

phenomenon,<sup>65</sup> but attorneys' and accountants' current willingness to sacrifice ethics is well illustrated by ACC/Lincoln. In that case, elderly bondholders who had been left destitute by the bankruptcy of Keating's ACC holding company and regulatory seizure of Lincoln sued accountants, lawyers and consultants whose professional services aided and abetted his criminal scheme. Three "national" law firms - Kaye Scholer,<sup>66</sup> Sidley &

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played by attorneys who aided and abetted thrift institutions' criminal wrongdoing); McCoy, Schmit & Bailey, *Hall of Shame: Besides S&L Owners, Host of Professionals Paved Way in Crisis*, Wall St. J., Nov. 2, 1990, at A1, col. 1; Wayne, *Where Were the Accountants?*, N.Y. Times, Mar. 12, 1989, § 3, at 1, col. 2 (detailing accounting firms' intimate involvement with numerous fraudulent thrifts).

<sup>65</sup> See *United States v. Benjamin*, 328 F.2d 854, 863 (2d Cir.) (Friendly, J.) (affirming convictions of lawyers and accountants for conspiracy to violate securities laws: "In our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar."), *cert. denied*, 377 U.S. 953 (1964).

<sup>66</sup> Kaye Scholer, ACC/Lincoln Savings' principal outside counsel, instigated and aided and abetted Keating's fraudulent scheme to mislead investors by assisting in preparation of a misleading securities prospectus. The law firm "knowingly assisted" Keating and his confederates to make ACC bonds appear safe to the investing public, assisted in forging documents to cover Lincoln's unsafe practices and lent "credibility" to unsound securities by permitting the use of the Kaye Scholer name in connection with the offering. Although it characterized investors' claims as "frivolous" when they were filed, just one year later Kaye Scholer paid \$20 million to settle those claims. See *Law Firm in Lincoln S&L Suit Agrees to Pay \$20 Million*, S.F. Chron., June 16, 1990, at A1; see also Note, *Securities Attorneys Face Liability For Wrongs of Their Corporate Clients*, 5 J. of Legal Comment. 403, 406-08 (1990) (detailing Kaye Scholer's involvement in Keating's multi-faceted fraudulent schemes). Two years later, Kaye Scholer agreed to pay \$41 million to settle Government accusations that it had improperly withheld damaging

Austin<sup>67</sup> and Jones, Day, Reavis & Pogue<sup>68</sup> – paid \$87 million to settle defrauded investors' claims. Bondholders also received \$103 million in settlements from accountants Arthur Young,<sup>69</sup> Arthur

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information about Lincoln from federal regulators conducting a 1986 exam of the thrift. See A. Stevens & P. Thomas, *How a Big Law Firm Was Brought to Knees By Zealous Regulators*, Wall St. J., Mar. 13, 1992, at A1, col. 8.

<sup>67</sup> Sidley & Austin, which fended off federal regulators' attempts to close Lincoln in 1987-1988 through misrepresentations and threats of personal liability upon federal regulators, and which also termed investors' lawsuits meritless and frivolous when they were filed, paid \$34 million to settle those claims. See J. Granelli, *Getting Their Day in Court*, L.A. Times, Mar. 1, 1992, at D-1.

<sup>68</sup> Jones Day, which agreed with Keating that it could "bill liberally" for legal services rendered in exchange for making political contributions at his direction, paid \$23 million to settle investors' claims. See Cox, *Just Why Did Jones Day Settle?*, Nat'l L.J., Apr. 13, 1992, at 1. Jones Day also paid \$51 million to settle RTC claims in connection with the law firm's work for Lincoln during a 1986 regulatory exam. See Jensen, *Jones Day: Behind the Settlement*, Nat'l L.J., July 5, 1993, at 1. During the exam, Jones Day lawyers laboring at Lincoln shrouded their work – and even their presence – in unusual secrecy; William Schilling, the Jones Day attorney in charge of determining whether the thrift was in regulatory compliance had months earlier been a federal regulator when he had received a memorandum detailing Lincoln's potentially disastrous condition; despite finding serious problems in the thrift's files – and by its own description being "shunted aside" for its blunt warnings – Jones Day not only failed to warn Lincoln's board of directors of the problems but also continued to be eager to accept other legal work from Keating. *Id.* at 32; see also ACC/Lincoln, 794 F. Supp. at 1449-54 (detailing law firm's willful involvement in scheme).

<sup>69</sup> Arthur Young (AY) partner Jack Atchison wrote advocacy letters to numerous U.S. Senators certifying Lincoln's financial condition and helped Keating convince several Senators (the "Keating Five") to intervene with federal regulators, as

Andersen<sup>70</sup> and Touche Ross,<sup>71</sup> demonstrating their willful involvement in the fraudulent scheme.

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well as misrepresenting Lincoln's collapsing financial condition. The resulting two-year delay before regulators could seize Lincoln cost the taxpayers an additional \$1 billion. Immediately after AY issued its year-end 1987 "clean" audit opinion certifying ACC/Lincoln's financial condition, Atchison resigned from the accounting firm and accepted a job from Keating paying over \$700,000 per year – four times his partnership compensation at AY. See Jackson, *New Disclosures of Riegle's Lincoln Role Suggest He Was More Than a Bystander*, Wall St. J., Nov. 15, 1989, at A28, col. 1; Jackson, *FBI Probe Focuses on Senators' Ties to Keating's S&L*, Wall St. J., Nov. 13, 1989, at A7B, col. 2. Ernst & Young (AY's successor) agreed to pay \$400 million to settle Government claims arising out of audits of seven thrifts, including Lincoln. See K. Bacon & L. Berton, *Ernst to Pay \$400 Million Over Audit of Four Big Thrifts*, Wall St. J., Nov. 24, 1992, at A3, col. 1.

<sup>70</sup> Arthur Andersen (AA) received \$3.7 million for providing clean audit opinions to ACC/Lincoln in 1984 and 1985. According to regulators, it fraudulently backdated loan file data and "stuffed" files with loan documentation. See Thomas, *Regulators Cite Delays and Phone Bugs in Examination, Seizure of Lincoln S&L*, Wall St. J., Oct. 27, 1989, at A4, col. 2; Granelli, *Keating Trial Focuses on Advisers*, L.A. Times, Mar. 14, 1992, at D1, col. 3. AA agreed to pay \$30 million to settle claims asserted by stockholders and bondholders after agreeing to pay \$25 million to settle claims brought by the RTC. See Jefferson & Berton, *Accounting Firm to Settle Suit on Thrift*, Wall St. J., Mar. 17, 1992, at A4, col. 1.

<sup>71</sup> Touche Ross improperly accepted the ACC/Lincoln engagement after AA and AY resigned and it misled federal regulators concerning the status of the 1988 audit, thereby delaying regulatory seizure of the thrift and permitting Keating to sell millions of dollars of worthless bonds to elderly investors. See ACC/Lincoln, 794 F. Supp. at 1441-47. Its successor (Deloitte & Touche) paid \$9 million to settle bondholders' claims four days before they were submitted to the jury (see note 49, *supra*).



As these scandals demonstrate, accountants continue to ignore their roles as public watchdogs, *see United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18 (1984), and they mislead this Court by contending that the specter of aiding and abetting liability has devastated their financial capability.<sup>72</sup> They improperly seek absolution from liability under § 10(b)/Rule 10b-5. Neither public policies underlying the federal securities laws, nor the laws themselves, should be subverted to provide errant professionals with such relief.

### III. CONCLUSION

For the reasons stated above, the decision of the court below should be affirmed.

DATED: September 10, 1993  
PRISCILLA R. BUDEIRI  
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<sup>72</sup> See Brief of AICPA as *Amicus Curiae* at 2, 17-19. The accounting profession argues that without liability reform, cases brought against auditing firms could wipe out their capital and insurance, expose partners' personal assets to seizure and drive them into bankruptcy. Although they claim that 1991 revenue for the Big Six was a mere \$5.3 billion, this figure includes only their accounting and auditing work; in fact, revenue for the Big Six in 1991, the most recent year available, was over \$29 billion. See *Int'l Accounting Data Book* (Lafferty Business Research 1992). In that year, legal fees and judgments were only 1.6% of revenue, rather than the 9.1% reported by the AICPA, and only 17% of the claims on the AICPA's liability insurance plans arises from audits, compared to 40% from tax-related services. See *Most Common Causes of Claims in AICPA Liability Insurance*, *Accounting Today*, July 20, 1992, at 2. When they are not pleading for relief from liability, accounting firms publicly boast that the cash flow from legal settlements has had little effect on their income. See S. Labaton, *\$400 Million Bargain for Ernst*, *N.Y. Times*, Nov. 25, 1992, at C1; C. Harlan, *Coopers & Lybrand Agrees to Payment of \$95 Million in the MiniScribe Case*, *Wall St. J.*, Oct. 30, 1992, at C1.



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In The  
Supreme Court of the United States

October Term, 1993

CENTRAL BANK OF DENVER, N.A.,

*Petitioner,*

vs.

FIRST INTERSTATE BANK OF DENVER, N.A.  
and JACK K. NABER,

*Respondents.*

On Writ Of Certiorari  
To The United States Court Of Appeals  
For The Tenth Circuit

BRIEF OF AMICUS CURIAE  
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AND COMMERCIAL LAW ATTORNEYS  
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**QUESTIONS PRESENTED**

1. Whether there is an implied private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.

- 2. Whether recklessness satisfies the scienter requirement for aiding and abetting even where there is no breach of a duty to disclose or to act.

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## I. INTEREST OF AMICUS CURIAE

The National Association of Securities and Commercial Law Attorneys ("NASCAT") is an association of law firms and attorneys located throughout the United States. The association advocates principled interpretation and application of the federal securities laws to protect investors from manipulative and deceptive practices and to ensure that United States securities markets operate freely and efficiently. NASCAT's members frequently represent victims of securities fraud in cases prosecuted under the federal securities laws. NASCAT and its members accordingly have an interest in the effective private enforcement of the federal securities laws.

NASCAT strongly opposes petitioner's argument that this Court should overrule nearly half a century of precedent under § 10(b) of the Securities Exchange Act (the "Exchange Act") by holding that the long-recognized liability of aiders and abettors who substantially assist the perpetration of securities fraud should now be abolished without congressional action. NASCAT also strongly opposes petitioner's arguments that this Court should overrule decades of precedent holding reckless indifference suffices to establish the element of scienter in cases such as this.

## II. INTRODUCTION

Petitioner and amici in their support have briefed this case as if the recognition of a damage claim for aiding and abetting a violation of § 10(b) was new, radical, and inconsistent with other closely related aspects of the securities laws. That is flatly incorrect.

Simply put, aiding and abetting securities fraud is a deceptive practice, and any deceptive or manipulative practice designed to mislead investors is actionable under § 10(b) and Rule 10b-5. *See* 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. Aiding and abetting a violation of § 10(b) exposes one to criminal liabilities and SEC enforcement

actions. No rational theory suggests that the same conduct does not expose the same parties to damage liability under the same statute. *See* pp. 3-17, *infra*. Not surprisingly, aiding and abetting a violation of § 10(b) has long been recognized to be civilly actionable for damages; indeed, its recognition was virtually simultaneous with the recognition of a private right of action. *See* pp. 10-17, *infra*.

If the language and purpose of the statute did not itself prohibit aiding and abetting securities fraud, still the general rule would apply that one who aids and abets violation of a statute is equally liable for violating the statute. *See* pp. 3-9, *infra*. Congress has, indeed, provided by express legislation that anyone who aids and abets the violation of a statute such as § 10(b) is a principal violator of the statute. *See* 18 U.S.C. § 2(a).

Because the implied cause of action always has encompassed liability for aiding and abetting securities fraud, holding aiders and abettors liable under § 10(b) does not require extension of the existing implied cause of action for violation of the statute – a cause of action that has been recognized for decades *and approved by Congress*. The question presented in this case is not whether the Court should create a new implied cause of action for aiding and abetting a violation of § 10(b), but whether this Court should overturn decades of settled precedent – acquiesced in and affirmatively approved by Congress – to hold that those who violate § 10(b) by aiding and abetting a securities fraud shall now be immune to civil damage liability to their victims, even though they can be jailed, enjoined, and ordered to disgorge unlawful profits to the SEC.

The second question presented is whether this Court should hold that those who recklessly aid and abet securities fraud should be immune to liability if they were not subject to some pre-existing duty to disclose or act. Petitioners ignore the fact that *everyone* has a duty not to perpetrate or to assist in fraud. *See* pp. 21-22, 28-30, *infra*.

The Courts of Appeal have uniformly held that recklessness satisfies the scienter requirement for a primary violation of § 10(b), and unless this Court intends to overturn that solid line of authority, the question presented is whether a different mental state is required when the charge is aiding and abetting. *See* pp. 22-30, *infra*.

In the law of fraud, reckless disregard for the truth has always been deemed a variety of intent to mislead. *See* pp. 22-30, *infra*. With respect to securities fraud, in particular, deception of investors is a foreseeable consequence of reckless conduct. A publicly traded corporation's insiders, its underwriters, lawyers and accountants, all act with scienter when, in reckless disregard for the truth and the rights of investors, they render substantial assistance to a securities fraud in violation of § 10(b).

### III. ARGUMENT

#### A. Aiding And Abetting Securities Fraud Is A Violation Of Section 10(b) And Rule 10b-5

Aiding and abetting a securities fraud consists of knowingly rendering substantial assistance or encouragement to the perpetration of that fraud.<sup>1</sup> Section 10(b)'s

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<sup>1</sup> *See* *Reves v. Ernst & Young*, 113 S. Ct. 1163, 1170 (1993) (" 'aid and abet' 'comprehends all assistance rendered by words, acts, encouragement, support or presence' ") (quoting *Black's Law Dictionary* 68 (6th ed. 1990)); *Restatement (Second) of Torts* § 876(b) (1979) ("one is subject to liability if he . . . knows that the other's conduct is a breach of duty and gives substantial assistance or encouragement to the other to so conduct himself"); *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673, 680 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970). The "elements" of liability have been variously stated in the case law, but "can be merged or articulated somewhat differently without affecting their basic thrust." *Halberstam v. Welch*, 705 F.2d 472, 478 n.8 (D.C. Cir. 1983).

language is broad enough to encompass liability for aiding and abetting.<sup>2</sup>

Going far beyond imposing liability for individual misrepresentations or omissions, § 10(b) and Rule 10b-5 prohibit *any* deceptive practice or course of conduct that operates to mislead investors in connection with the purchase or sale of securities.<sup>3</sup> To knowingly participate in such a fraudulent practice or course of conduct, whether "directly or indirectly," 15 U.S.C. § 78j, is a violation of the section and Rule.<sup>4</sup>

To knowingly render substantial assistance to a fraudulent course of conduct is, in essence, to participate in it. Thus, in *Nye & Nissen v. United States*, 336 U.S. 613, 618-20 (1949), this Court held that one who aids and abets fraud is himself guilty *as a principal of that fraud*. *Id.* The rule makes sense. A scheme to defraud typically involves multiple parties who conspire with, or aid and abet, one another in order to perpetrate the fraudulent scheme. "[A]ll members" of such a scheme "are responsible."<sup>5</sup>

<sup>2</sup> The statute makes it unlawful "directly or indirectly" to "use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b). Rule 10b-5, in turn, makes it unlawful for any person "directly or indirectly" to employ "any device, scheme, or artifice to defraud," 17 C.F.R. § 240.10b-5(a), to make any misleading statements, 17 C.F.R. § 240.10b-5(b), or to "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. § 240.10b-5(c).

<sup>3</sup> *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 152-53 (1972); *Molecular Technology Corp. v. Valentine*, 925 F.2d 910, 917 (6th Cir. 1991); *In re Union Carbide Corp. Consumer Products Business Sec. Litig.*, 676 F. Supp. 458, 466-69 (S.D.N.Y. 1987).

<sup>4</sup> *In re Union Carbide*, 676 F. Supp. at 466-69; see *In re Rospatch Sec. Litig.*, 760 F. Supp. 1239, 1249, 1251-52 (W.D. Mich. 1991).

<sup>5</sup> *Pinkerton v. United States*, 328 U.S. 640, 647 (1946) (mail fraud); accord *Herpich v. Wilder*, 430 F.2d 818, 819 (5th Cir. 1970) (securities

"One or more persons can originate and carry out a scheme to defraud and any number of persons can operate the plan, each doing his part after the machinery is put in motion; and it would be of no consequence that each and all did not actively participate in the several acts . . . if each were aiding and advising in furtherance of the scheme."<sup>6</sup>

Petitioner urges this Court to ignore § 10(b)'s broad proscription of deceptive practices and to depart from general principles of law, understood by the Congress that enacted § 10(b), in order to abolish the liability of aiders and abettors. When Congress enacted § 10(b), American decisions had long recognized "the general principle of the law is that all procurers and abettors of statutory offenses are punishable under the statute, although not expressly referred to in the statute."<sup>7</sup> This rule applied in civil litigation<sup>8</sup> as well as in criminal

fraud), *cert. denied*, 401 U.S. 947 (1971); *Rooney Pace, Inc. v. Reid*, 605 F. Supp. 158, 160-61 & n.5 (S.D.N.Y. 1985) (securities fraud).

<sup>6</sup> *United States v. Melton*, 689 F.2d 679, 684 (7th Cir. 1982) (mail fraud) (quoting *Reuben v. United States*, 86 F.2d 464, 469 (7th Cir. 1936), *cert. denied*, 300 U.S. 671 (1937)).

<sup>7</sup> *United States v. Bayer*, 24 Fed. Cas. 1046, 1047 (C.C.D. Minn. 1876) (No. 14,547). The leading American treatise on statutory offenses explained that "all persons present giving aid and comfort to another committing an offense, even a felony, are regarded as principals; that is, in legal contemplation doing the deed." Joel Prentiss Bishop, *Commentaries on the Law of Statutory Crimes* § 135, at 142 (3d ed. 1901). "Therefore, if a statute makes the doing of a thing criminal, it includes, with the actual doer, persons who are present lending their countenance and aid." *Id.*

<sup>8</sup> See, e.g., *Toledo A.A. & N.M.R. Co. v. Pennsylvania Co.*, 54 F. 730, 736-37 (C.C.N.D. Ohio) (invoking the rule, in civil litigation, that aiders and abettors of violation of § 10 of the Interstate Commerce Act are liable as principals), *appeal dismissed sub nom. Ex Parte Lennon*, 150 U.S. 393 (1893).



proceedings,<sup>9</sup> and became a part of the general tort law which imposed liability on aiders and abettors.<sup>10</sup>

Congress codified the rule in 1909, abolishing any lingering common law limitations on its application:<sup>11</sup>

Whoever directly commits any act constituting an offense defined in any law of the United States, or aids, abets, counsels, commands, induces or procures its commission, is a principal.

Act of March 4, 1909, ch. 321, § 332, 35 Stat. 1152 (1909).

<sup>9</sup> See, e.g., *United States v. Snyder*, 14 F. 554, 555-56 (C.C.D. Minn. 1882) (applying "the rule that all . . . abettors of statutory offenses are punishable under the statutes"); *United States v. Stevens*, 44 F. 132, 139-40 (C.C.D. Minn. 1890); *United States v. Harbison* 26 F. Cas. 130, 130-31 (C.C.E.D. Tenn. 1871) (No. 15,300).

<sup>10</sup> See, e.g., *Virtue v. Creamery Package Mfg. Co.*, 123 Minn. 17, 40, 142 N.W. 930, 939 (1913) ("all who actively participate in any manner in the commission of a tort, or who procure, command, direct, advise, encourage, aid, or abet its commission . . . are jointly and severally liable therefore"); *Cross v. Sylvia Silk Co.*, 222 A.D. 134, 135-36, 225 N.Y.S. 552, 554 (1927).

<sup>11</sup> See *Standefer v. United States*, 447 U.S. 10, 18-19 (1980); *United States v. Martin*, 176 F. 110, 113-14 (D. Iowa 1910). Although common law had long held that aiders and abettors could be punished as principal offenders some decisions – particularly those of English courts – had imposed certain exceptions and procedural qualifications when the rule was applied to felonies. See *Standefer*, 447 U.S. at 15-18; *United States v. Martin*, 176 F. at 112. The distinction between misdemeanor and felony had far less significance in American law where it was abolished by statute, limited judicially, or simply ignored. See, e.g., *Rosencranz v. United States*, 155 F. 38, 43 (9th Cir. 1907); *People v. Newberry*, 20 Cal. 439, 441 (1862); *State v. Poynier*, 36 La. Ann. 572, 574 (1884); *Commonwealth v. Ray*, 69 Mass. (3 Gray) 441, 448 (1855); *McGowan v. State*, 17 Tenn. (9 Yerger) 184, 194 (1836).

Now codified as amended at 18 U.S.C. § 2(a),<sup>12</sup> the rule applies in civil litigation<sup>13</sup> as well as in criminal proceedings.<sup>14</sup>

With this enactment Congress provided that aiding and abetting the violation of *any* federal criminal statute shall itself constitute a principal violation of that statute. Congress " 'abolishe[d] the distinction between principals and accessories and [made] them all principals.' "<sup>15</sup>

When Congress enacted § 10(b) it understood that such a statute, making securities fraud illegal, would also make aiding and abetting securities fraud illegal. Federal courts and the SEC properly found no difficulty in holding that aiding and abetting a violation of the federal securities laws is itself a violation of those laws. See, e.g., *SEC v. Scott Taylor & Co.*, 183 F. Supp. 904, 909 n.12 (S.D.N.Y. 1959); *SEC v. Timetrust, Inc.*, 28 F. Supp. 34, 43 (N.D. Cal. 1939), *appeal dismissed*, 118 F.2d 718 (9th Cir.

<sup>12</sup> Although the language of 18 U.S.C. § 2(a) has been modified slightly over the years, there is " 'no evidence of any Congressional intent to change the substantive law that an aider and abettor is a principal.' " *United States v. Oates*, 560 F.2d 45, 55 (2d Cir. 1977) (quoting *Swanne Soon Young Pang v. United States*, 209 F.2d 245, 246 (9th Cir. 1953)); see *Standefer*, 447 U.S. at 20. "In other words, one who aids and abets the commission of a crime is not only punishable as a principal but is a principal." *United States v. Oates*, 560 F.2d at 54.

<sup>13</sup> E.g., *Berlin Communications, Inc. v. FCC*, 626 F.2d 869, 874 & n.13 (D.C. Cir. 1979) (broadcasting license revocation based on application of 18 U.S.C. § 2). The modern tort law's recognition of aider and abettor liability is reflected in § 876(b) of the *Restatement (Second) of Torts*.

<sup>14</sup> See, e.g., *United States v. Blitz*, 533 F.2d 1329, 1341 (2d Cir.) (applying 18 U.S.C. § 2 to violations of § 10(b)), *cert. denied*, 429 U.S. 819 (1976).

<sup>15</sup> *Standefer*, 447 U.S. at 19 (quoting *Hammer v. United States*, 271 U.S. 620, 628 (1926)); see *United States v. Pino-Perez*, 870 F.2d 1230, 1233 (7th Cir.) (*en banc*), *cert. denied*, 493 U.S. 901 (1989); *United States v. Oates*, 560 F.2d at 55.

1941); *Matter of Burley & Co.*, 23 S.E.C. 461, 468 n.11 (1946) (Exchange Act Release No. 3838).

Since those early cases, the circuit courts have uniformly concluded that aiding and abetting securities fraud is a violation of § 10(b) and Rule 10b-5. "Under § 10(b) and Rule 10b-5 knowing assistance of or participation in a fraudulent scheme gives rise to liability equal to that of the perpetrators themselves." *Kerbs v. Fall River Industries, Inc.*, 502 F.2d 731, 740 (10th Cir. 1974). "Aiding and abetting is itself a violation of section 10(b) and Rule 10b-5." *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d 646, 652 (9th Cir. 1988), *cert. denied*, 493 U.S. 1002 (1989).<sup>16</sup> Federal courts have similarly recognized that aiding and abetting violations of §§ 9 and 18 of the Exchange Act are actionable,<sup>17</sup> and they have accepted the SEC's authority to bring enforcement actions against aiders and abettors of many securities law violations.<sup>18</sup>

<sup>16</sup> *Accord, e.g., Gross v. SEC*, 418 F.2d 103, 107 (2d Cir. 1969); *Winkler v. SEC*, 377 F.2d 517, 518 (2d Cir. 1967); *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 799 (3d Cir.), *cert. denied*, 439 U.S. 930 (1978); *Fine v. American Solar King Corp.*, 919 F.2d 290, 300 (5th Cir. 1990), *cert. dismissed*, 112 S. Ct. 576 (1991); *Herm v. Stafford*, 663 F.2d 669, 684 (6th Cir. 1981); *SEC v. Washington County Utility District*, 676 F.2d 218, 224 (6th Cir. 1982); *SEC v. First Securities Co.*, 463 F.2d 981, 987 (7th Cir.), *cert. denied*, 409 U.S. 880 (1972); *Carroll v. First National Bank*, 413 F.2d 353, 357 (7th Cir. 1969), *cert. denied*, 396 U.S. 1003 (1970); *Metge v. Baehler*, 762 F.2d 621, 624 (8th Cir. 1985), *cert. denied*, 474 U.S. 1057 & 1072 (1986); *Little v. Valley National Bank*, 650 F.2d 218, 222-23 (9th Cir. 1981); *Woods v. Barnett Bank*, 765 F.2d 1004, 1009 (11th Cir. 1985); *Batten & Co. v. SEC*, 345 F.2d 82, 83-84 (D.C. Cir. 1964).

<sup>17</sup> *See, e.g., SEC v. Militano*, 773 F. Supp. 589, 591 & 594-95 (S.D.N.Y. 1991) (§ 9); *In re Caesar's Palace Sec. Litig.*, 360 F. Supp. 366, 386 (S.D.N.Y. 1973) (§ 18); *Sennott v. Rothbart*, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,851 (N.D. Ill. 1970) (§ 9), *rev'd on other grounds sub nom. Sennott v. Rodman & Renshaw*, 474 F.2d 32, 39 (7th Cir.), *cert. denied*, 414 U.S. 926 (1973).

<sup>18</sup> *See, e.g., SEC v. Falstaff Brewing Corp.*, 629 F.2d 62, 72-73, (D.C. Cir.) (§ 13(a)), *cert. denied*, 449 U.S. 1012; *SEC v. Coven*, 581 F.2d 1020

This aiding and abetting liability, which is both mandated by Congress through 18 U.S.C. § 2(a) and recognized in decisional law, *does not* create a new, separate or distinct offense.<sup>19</sup> The rule that aiders and abettors are liable as principals "only serves as a more particularized way of identifying the 'persons involved' in the commission of the substantive offense, and serves to describe how those 'person[s] involved,' committed the substantive offense."<sup>20</sup> Thus, the question presented is not whether this Court should create a new liability under § 10(b) but whether it should, without congressional action, overrule settled precedent in order to *eliminate* a well grounded and long recognized theory of liability.

(2d Cir. 1978) (§ 17(a)), *cert. denied*, 440 U.S. 950 (1979); *SEC v. Universal Major Industries, Corp.*, 546 F.2d 1044, 1046 (2d Cir. 1976) (§ 5), *cert. denied*, 434 U.S. 834 (1977); *Wellman v. Dickenson*, 475 F. Supp. 783, 831-32 (S.D.N.Y. 1979) (§ 14), *aff'd*, 682 F.2d 355 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983).

<sup>19</sup> *Ruthenberg v. United States*, 245 U.S. 480, 481, 483 (1918) (one defendant's refusal to register for the draft, and other defendants' aiding and abetting that refusal, amount to "but one offense," the aiders and abettors "being charged as principals in procuring [the] refusal"); *see Hammer*, 271 U.S. at 628; *United States v. Erb*, 543 F.2d 438, 446 (2d Cir.) ("[Appellant's] premise is that aiding and abetting is a crime separate from the substantive offense abetted. This is not so."), *cert. denied*, 429 U.S. 981 (1976); *United States v. Pearson*, 667 F.2d 12, 13-14 (5th Cir. 1982) (en banc); *United States v. Moya-Gomez*, 860 F.2d 706, 756 (7th Cir. 1988), *cert. denied*, 492 U.S. 908 (1989); *United States v. Thirion*, 813 F.2d 146, 151 (8th Cir. 1987); *United States v. Stitzer*, 785 F.2d 1506, 1519 n.7 (11th Cir.), *cert. denied*, 479 U.S. 823 (1986); *United States v. Kegler*, 724 F.2d 190, 200-01 (D.C. Cir. 1983); *United States v. J.R. Watkins Co.*, 127 F. Supp. 97, 101 (D. Minn. 1954).

<sup>20</sup> *United States v. Oates*, 560 F.2d at 54 (emphasis added) (quoting *United States v. Campbell*, 426 F.2d 547, 553 (2d Cir. 1970)). "[T]he aiding and abetting statute, 18 U.S.C. § 2, provides a means of establishing liability but does not itself define a crime." *Baumann v. United States*, 692 F.2d 565, 571 (9th Cir. 1982) (citation omitted); *see supra*, note 19.



**B. Since Its Inception The Implied Cause Of Action Under Section 10(b) Has Encompassed "Secondary Liability"**

Since the 1940s federal courts have recognized an implied private right of action for violations of § 10(b). See, e.g., *Fry v. Schumaker*, 83 F. Supp. 476 (E.D. Pa. 1947); *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946). These initial decisions recognized damage claims based on allegations of *aiding and abetting* violation of § 10(b) and *conspiracy* to violate § 10(b).<sup>21</sup>

Once an implied cause of action is created under a federal statute, such "secondary" liability principles necessarily apply in litigation based on the implied cause of action. In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982), this Court held that "[h]aving concluded that exchanges can be held accountable" in private actions implied under the Commodity Exchange Act, "it necessarily follows that those persons who are participants in a conspiracy to manipulate the market in violation of those rules are also subject to suit by futures traders who can prove injury from these violations." *Id.* at 394 (emphasis added). The Court did not distinguish between implied liability for direct violations of the act and implied liability for conspiring to violate the act. For the same reasons, the Court should not now create a distinction between liability for direct violations of § 10(b) and liability for aiding and abetting such violations.

If conspiracy or aiding and abetting can fairly be characterized as "secondary" liability, they nevertheless are well engrained in our law and have always been a part of the private cause of action under § 10(b). "The

<sup>21</sup> See *Fry*, 83 F. Supp. at 476; *Kardon*, 69 F. Supp. at 512; see also *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673, 675-82 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970); *Pettit v. American Stock Exchange*, 217 F. Supp. 21, 28 (S.D.N.Y. 1963).

right of action was first recognized in *Kardon v. National Gypsum Co.*," when Judge William F. Kirkpatrick of the United States District Court for the Eastern District of Pennsylvania held that allegations of *conspiracy* to defraud stated a violation of the statute that gave rise to a private cause of action for damages.<sup>22</sup> The following month *Fry* held that stock brokers who *aided and abetted* a scheme to defraud could be held liable in a private suit under § 10(b):

No matter how innocent the brokers' solicitation letter may have appeared and without regard to whether it contained any fraudulent or misleading statement of fact, if the brokers know, as averred, that it was part of a scheme to defraud an action would lie against them. In fact, it would be sufficient if they had merely mailed a letter without knowing its contents or even had merely supplied their stationery, provided they knew that in so doing they were rendering service essential to or participating in a scheme of fraud.

*Fry*, 83 F. Supp. at 478 (emphasis added).

The court acknowledged that the complaint "[did] not charge (and appears rather carefully to avoid charging) that the brokers knew of any of the details of the scheme of fraud alleged to have been put into operation by the other defendants or knew of the fraudulent statements alleged to have been made by them." *Id.* It was enough, however, that the brokers had knowingly assisted the fraudulent scheme:

[I]t seems too plain for argument that a defendant cannot escape liability in an action for

<sup>22</sup> *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 n.10 (1983); see *Kardon*, 69 F. Supp. at 514-15. The leading advocate of weakening securities law enforcement by eliminating secondary liability admits "the case in which an implied private right of action under section 10(b) was first recognized, *Kardon v. National Gypsum Co.*, involved a cause of action alleging conspiracy." Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Calif. L. Rev. 80, 85 (1981).



fraud merely by showing that he was ignorant of the steps by which a fraudulent scheme was to be carried out if it appears that he knew that what he did was a part of it. The averment here, that the brokers sent a solicitation letter knowing that in so doing they were participating in a scheme to defraud, sufficiently states a cause of action at common law against them.

*Id.* Because the defendant brokers could be held liable under common law principles as "conspirators or joint tortfeasors," the court held, "it follows that the [complaint] states a cause of action against them for violations of the Statute and regulations which are, if anything broader than the common law." *Id.*

Thus, the first two opinions recognizing an implied right of action under § 10(b), *Kardon and Fry*, established an implied right of action that encompassed conspiracy and aiding and abetting concepts from the very beginning. Since then, federal courts have reaffirmed, time and again, that aiding and abetting securities fraud gives rise to a private cause of action.<sup>23</sup> It is far too late in the day to change the law on this point without congressional concurrence as this Court, and Congress, have both long approved of or acquiesced in the private cause of action implied in *Kardon and Fry*.<sup>24</sup>

<sup>23</sup> See, e.g., *Brennan*, 259 F. Supp. at 675-82; *Pettit*, 217 F. Supp. at 28; see also *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 44-48 (2d Cir.), cert. denied, 439 U.S. 1039 (1978); *Monsen*, 579 F.2d at 799-801; *Moore v. Fenex, Inc.*, 809 F.2d 297, 305 (6th Cir.), cert. denied, 483 U.S. 1006 (1987); *FDIC v. First Interstate Bank*, 885 F.2d 423, 424, 432 (8th Cir. 1989); *Little*, 650 F.2d at 223; *Zabriskie v. Lewis*, 507 F.2d 546, 553 (10th Cir. 1974); *Kerbs*, 502 F.2d at 740; *Woods*, 765 F.2d at 1009.

<sup>24</sup> "Such claims are of judicial creation, having been implied . . . for nearly half a century. . . . [T]his Court repeatedly has recognized the validity of such claims . . . ." *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773, 2779-80 (1991) (citing

In *Merrill Lynch* this Court held that "the fact a comprehensive reexamination and significant amendment of the [Commodities Exchange Act] left intact the statutory provisions under which the federal courts had implied a cause of action is itself evidence that Congress affirmatively intended to preserve that remedy." *Merrill Lynch*, 456 U.S. at 65-66. When Congress revised the securities laws in 1975, it preserved the implied right of action under § 10(b) against aiders and abettors of securities fraud. In *Herman & MacLean v. Huddleston*, this Court observed that in light of the "well established judicial interpretation" of the § 10(b) cause of action, "Congress' decision to leave § 10(b) intact" when it comprehensively revised the securities laws in 1975 "suggests that Congress ratified the cumulative nature of the § 10(b) action." 459 U.S. at 385-86. "Congress' decision to leave § 10(b) intact," *id.*, in 1975 also suggests that it ratified the private right of action including its conspiracy and aiding and abetting principles. See *id.*

Since 1975 Congress has twice acted to preserve the implied cause of action under § 10(b) which, from the very beginning, encompassed "secondary liability" principles.<sup>25</sup> The existence of the implied right of action and

*Kardon*); see also *Herman & MacLean v. Huddleston*, 459 U.S. at 380 n.10 (citing *Kardon*); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975) (citing *Kardon*). "Judicial interpretation and application, legislative acquiescence, and the passage of time have removed any doubt that a private cause of action exists for a violation of § 10(b) and Rule 10b-5, and constitutes an essential tool for enforcement of the 1934 Act's requirements." *Basic Inc. v. Levinson*, 485 U.S. 224, 230-231 (1988) (citations omitted). "The existence of this implied remedy is simply beyond peradventure." *Herman & MacLean v. Huddleston*, 459 U.S. at 380.

<sup>25</sup> In 1988, when it enacted § 20A of the Exchange Act, Congress expressly provided that "[n]othing in this section shall be construed to limit or condition . . . the availability of any cause of action implied from a provision of this chapter." 15 U.S.C. § 78t-1(d). Even more recently, Congress expressly provided for reinstatement

the federal courts' "cumulative work in its design" were "obvious legislative considerations" in these two recent statutes that "treat[] the 10b-5 action as an accepted feature of our securities laws." *Musick, Peeler & Garrett v. Employers Insurance of Wausau*, 113 S. Ct. 2085, 2089 (1993) (emphasis added).

This Court should not overturn half a century of precedent ratified by Congress – particularly where doing so would conflict with the underlying policy of the securities laws. The aim of Congress in passing the Exchange Act was in large part "to deter fraud and manipulative practices in the securities markets, and to ensure full disclosure of information material to investment decisions." *Randall v. Loftsgaarden*, 478 U.S. 647, 664 (1986). Liability of aiders and abettors of fraud is crucial to the effective operation of our securities laws.<sup>26</sup> As the Second Circuit pointed out in *United States v. Benjamin*, 328 F.2d

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of implied private civil actions under § 10(b) that otherwise would have been barred by this Court's holding in *Lampf*. See 15 U.S.C. § 78aa-1.

<sup>26</sup> Discussing liability of aiders and abettors under § 5 of the Securities Act, the Second Circuit explained:

In order to accomplish the broad remedial purposes of the Securities Acts, there are compelling reasons to impose [aiding and abetting] liability in Section 5 [15 U.S.C. § 77e] actions. By its terms, Section 5 makes it unlawful, "directly or indirectly" to sell unregistered stock. *The heart of the prohibition would be cut away if the only person covered by its provisions was the individual who actually consummated the sale.* We do not believe the Supreme Court [in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976)] intended that those who play an indispensable role in the sale, as appellant did here, should not be subject to SEC initiated, injunctive restraint.

*SEC v. Universal Major Industries*, 546 F.2d at 1046 (emphasis added; citation omitted).

854, 863 (2d Cir.) (Friendly, J.), cert. denied, 377 U.S. 953 (1964):

In our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar. . . . Congress . . . could not have intended that men holding themselves out as members of these ancient professions should be able to escape criminal liability on a plea of ignorance when they have shut their eyes to what was plainly to be seen or have represented a knowledge they knew they did not possess.

*Id.*

An aider and abettor of a § 10(b) violation who may be held accountable in an SEC enforcement action or criminal prosecution must also be held accountable to the victims of the fraud. This Court has *rejected* the notion that § 10(b) means one thing for SEC actions and something very different for everyone else. *Aaron v. SEC*, 446 U.S. 680, 691 (1980). Moreover, "[i]mplied private actions provide 'a most effective weapon in the enforcement' of the securities laws and 'are a necessary supplement to Commission action.'"<sup>27</sup> Rendering aiders and abettors of securities fraud immune to such suits would seriously undermine the deterrence and disclosure goals of the Exchange Act.

Compensating defrauded investors is another essential purpose of the Exchange Act, see *Randall*, 478 U.S. at 647, that would suffer if aider and abettor liability were abolished. The cause of the investors' injuries seldom is the conduct of a single principal violator:

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<sup>27</sup> *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (quoting *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964)). The implied private right of action under § 10(b) "constitutes an essential tool for enforcement of the 1934 Act's requirements." *Basic Inc.*, 485 U.S. at 231 (citation omitted).



It is now well settled that accountants who aid and abet others in violating the anti-fraud provisions of the securities laws may be held jointly liable with such persons in private actions for damages. . . . *To deny . . . investors, who were injured by this combined fraudulent conduct, a cause of action against all of the wrongdoers would leave the plaintiffs with half a remedy and would run afoul of the Supreme Court's repeated admonition that the securities laws are to be construed "not technically and restrictively, but flexibly to effectuate [their] remedial purposes."*

*Bolger v. Laventhol, Krekstein, Horwath & Horwath*, 381 F. Supp. 260, 268 (S.D.N.Y. 1974) (emphasis added) (quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963)).

The language and purpose of § 10(b), general principles of law, and nearly half a century of precedent *repeatedly ratified by Congress* all mandate continued recognition of aider and abettor liability under § 10(b).

### C. There Is No Reason To Exclude Aiding And Abetting Violations Of Section 10(b) From The Violations That Give Rise To An Implied Cause Of Action

To avoid application of the general rule that aiding and abetting violation of a statute is itself a violation requires " 'an affirmative legislative policy' to create an exemption from the ordinary rules of accessory liability." <sup>28</sup> Petitioner contends that Congress implicitly rejected

<sup>28</sup> *Pino-Perez*, 870 F.2d at 1234 (citations omitted). The burden is on petitioner to show that in enacting § 10(b) Congress intended a special exemption from the usual rules of liability for aiders and abettors. See *Pino-Perez*, 870 F.2d at 1233. Shifting the burden to the respondent to demonstrate a special Congressional intent to impose aider and abettor liability "would essentially abolish federal aider and abettor liability." *Id.* at 1234.

liability of aiders and abettors when it provided for "controlling person" liability in § 20(a) of the Exchange Act, and that subsequent legislative action (or inaction) eliminated any private cause of action for aiding and abetting. These arguments lack merit.

### 1. Congress' Extension of Liability To Controlling Persons Raises No Inference That It Intended To Eliminate More Traditional Theories Of Liability

No inference against traditional theories of secondary liability can be drawn from Congress' express provision for "controlling person" liability in the Exchange Act.

Congress knew that it did not have to say anything about aiding and abetting or conspiracy for § 10(b) to reach such conduct.<sup>29</sup> Applying traditional principles of law any participant, including those who knowingly assisted the wrong – would be liable.<sup>30</sup> Principals would be liable for acts of their agents, and employers for the wrongs of their employees committed in the course of employment.<sup>31</sup> *But the traditional principles did not reach far enough for Congress.*

Conspiracy and aiding and abetting principles require a prima facie showing of *some wrongful conduct* by the defendant – either an agreement to do wrong (conspiracy) or culpable assistance of the wrong (aiding and abetting). Respondeat superior liability reaches corporate

<sup>29</sup> See *Pino-Perez*, 870 F.2d at 1233. No inference against "secondary" liability can be drawn from the fact that Congress did not identify "aiding and abetting" or "conspiracy" by name when it outlawed fraudulent practices with § 10(b) – for to identify these theories of liability by name would have been the merest surplusage. See *id.* at 1234.

<sup>30</sup> See *Merrill Lynch*, 456 U.S. at 394; *Nye*, 336 U.S. at 618-20; *Restatement (Second) of Torts* § 876(b).

<sup>31</sup> See *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1576-77 (9th Cir. 1990) (en banc), *cert. denied*, 111 S. Ct. 1621 (1991).



employers, but it does not reach corporate officers or others who may in fact control the actions of a company and its employees. For this reason Congress enacted § 20(a) of the Exchange Act which extends liability to controlling persons. 15 U.S.C. § 78t(a). To establish prima facie liability a plaintiff need not show a controlling person was a "culpable participant" in the wrongful conduct.<sup>32</sup>

By thus extending liability beyond the traditional boundaries of aiding and abetting, conspiracy, and respondeat superior principles, "§ 20(a) was intended to supplement, and not to supplant" the traditional theories of liability.<sup>33</sup> "[T]here is no warrant for believing that Section 20(a) was intended to narrow the remedies" available to victims of fraud, "or to create a novel defense in cases otherwise governed by traditional agency principles." *Marbury Management*, 629 F.2d at 716; accord *Hollinger*, 914 F.2d at 1577. The section's legislative "history does not reflect any congressional intent to restrict secondary liability for violations."<sup>34</sup>

<sup>32</sup> See *First Interstate Bank v. Pring*, 969 F.2d 891, 897-98 (10th Cir. 1992), cert. granted, 113 S.Ct. 2927 (1993); *Hollinger*, 914 F.2d at 1574-75; *Metge*, 762 F.2d at 632; see also *Marbury Management, Inc. v. Kohn*, 629 F.2d 705, 716 (2d Cir. 1980), cert. denied, 449 U.S. 1011 (1980); *Richardson v. MacArthur*, 451 F.2d 35, 41-42 (10th Cir. 1971).

<sup>33</sup> *Hollinger*, 914 F.2d at 1576; accord, e.g., *In re Atlantic Financial Management, Inc.*, 784 F.2d 29, 32-34 (1st Cir. 1986), cert. denied, 481 U.S. 1072 (1987); *Marbury Management*, 629 F.2d at 712-16; *Holloway v. Howerdd*, 536 F.2d 690, 694-95 (6th Cir. 1976); *Fey v. Walston & Co.*, 493 F.2d 1036, 1052 (7th Cir. 1974); *Commerford v. Olson*, 794 F.2d 1319, 1322-23 (8th Cir. 1986); *Kerbs*, 502 F.2d at 731, 740-41; see David S. Ruder, *Multiple Defendants In Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution*, 120 U. Pa. L. Rev. 597, 605-07 (1972).

<sup>34</sup> *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118 (5th Cir. 1980); see William H. Kuehnle, *Secondary Liability Under the Federal Securities Laws - Aiding and Abetting, Conspiracy, Controlling Person, and Agency: Common Law Principles and Statutory*

For this Court to hold that - instead of extending liability to controlling persons - § 20(a) eliminates liability of culpable participants in fraudulent conduct, would be to give the section quite the opposite of its intended meaning and effect.<sup>35</sup>

## 2. Subsequent Legislative Action And Inaction Did Not Destroy Aider And Abetter Liability Under Section 10(b)

Petitioner suggests that legislative action (and inaction) since 1934 has had the effect of abolishing liability of aiders and abettors under § 10(b). Petitioner is wrong.

Petitioner contends that aiding and abetting liability under § 10(b) was rejected by Congress in 1959 when it declined to enact a proposed amendment to the securities acts that would have expressly imposed liability on aiders and abettors. However, such "Congressional inaction lacks 'persuasive significance' because 'several equally tenable inferences' may be drawn from such inaction, 'including the inference that the existing legislation already incorporated the offered change.'" <sup>36</sup>

*Scheme*, 14 J. Corp. L. 313, 351-54 (1988); Ruder, *supra* note 33, at 605-07.

<sup>35</sup> In *Herman & MacLean v. Huddleston*, this Court rejected arguments that Congress' provision for special liabilities and defenses under § 11 of the Securities Act could exempt conduct subject to § 11 from liability under § 10(b): "It would be anomalous indeed if the special protection afforded to purchasers in a registered offering by the 1933 Act were deemed to deprive such purchasers of the protections against manipulation and deception that § 10(b) makes available to all persons who deal in securities." 459 U.S. at 383. It would be even more anomalous to hold that a provision intended to extend the scope of liability under § 10(b) should instead operate to contract it and to immunize conspirators and aiders and abettors of fraud from liability for their wrongs.

<sup>36</sup> *Pension Benefit Guaranty Corp. v. LTV Corp.*, 496 U.S. 633, 650 (1990) (quoting *United States v. Wise*, 370 U.S. 405, 411 (1962)).

In fact, the legislative history shows that the amendment was rejected as unnecessary because aiders and abettors were already liable under existing law.<sup>37</sup>

Petitioner also contends that a subsequent amendment to § 15, to clarify the SEC's enforcement authority over brokers and dealers, had the effect – by implication – of eliminating all other liability of aiders and abettors. If Petitioner is correct it is difficult to explain how the SEC has continued to pursue so many enforcement actions beyond those authorized by § 15 against aiders and abettors of various securities violations.<sup>38</sup> Moreover, petitioner's argument "would surely do violence to the 'cardinal rule . . . that repeals by implication are not favored.'" *TVA v. Hill*, 437 U.S. 153, 189 (1978) (citations omitted). "In practical terms, this 'cardinal rule' means

<sup>37</sup> See S. Rep. No. 1757, 86th Cong., 2d Sess. 8-9 (1960). The amendment was understood by the SEC to be only a "clarification" of the existing law designed to "make it clear that an indirect violation of the act is unlawful." *Hearings on S. 1178-1182 Before A Subcommittee of the Senate Committee on Banking and Currency*, 86th Cong., 1st Sess. 275-76 (1959). "[A]t that time the *Timetrust*, *Scott Taylor*, and *Fry* cases had all been decided," *Brennan*, 259 F. Supp. at 678, and the SEC had for decades exercised enforcement authority over aiding and abetting violations of § 10(b). See *Matter of Burley & Co.*, 23 S.E.C. at 468 n.11 (1946). Under such circumstances Petitioner cannot "successfully contend that the failure to pass the clarifying amendment shows a Congressional intent that [§ 10(b)] has no applicability to aiders and abettors." *Brennan*, 259 F. Supp. at 678.

<sup>38</sup> The SEC has continued to prosecute aiding and abetting violations of § 10(b) and Rule 10b-5 in its civil enforcement actions, and federal courts have uniformly accepted its authority to do so. See, e.g., *SEC v. Washington County Utility District*, 676 F.2d at 224; *SEC v. Spectrum, Ltd.* 489 F.2d 535, 542 (2d Cir. 1973); *Winkler*, 377 F.2d at 518; *SEC v. Kimmes*, 799 F. Supp. 852, 859 (N.D. Ill. 1992); *SEC v. National Student Marketing Corp.*, 402 F. Supp. 641, 648 (D.D.C. 1975). The SEC also has continued to prosecute aiding and abetting violations of other provisions of the securities laws, without the express statutory authorization petitioner contends is necessary to create liability under § 10(b). See *supra* notes 18, 26.

that '[i]n the absence of some affirmative showing of an intention to repeal, the only permissible justification for a repeal by implication is when the earlier and later statutes are irreconcilable.'" *TVA*, 437 U.S. at 190 (citation omitted).

No affirmative intention to repeal aider and abettor liability can be shown and any suggestion that liability for aiding and abetting is somehow "irreconcilable" with SEC enforcement authority is simply ludicrous. The "positive repugnancy" required for a repeal by implication is altogether missing. *TVA*, 437 U.S. at 190. Congress did not, by clarifying SEC enforcement authority over brokers and dealers in § 15, intend to abrogate liability of aiders and abettors more generally.

#### D. Recklessness Satisfies The Scienter Element Of Aider And Abettor Liability

Aiding and abetting the violation of a statute necessarily entails an element of willful or purposive behavior. "In order to aid and abet another to commit a crime it is necessary that a defendant 'in some sort associate himself with the venture, that he participate in it as in something that he wishes to bring about, that he seek by his action to make it succeed.'" *Nye & Nissen*, 336 U.S. at 619 (quoting *United States v. Peoni*, 100 F.2d 401, 402 (2d Cir. 1938)). However, because "[a]iding and abetting is not a separate crime but rather is linked to the underlying offense," it also "shares the requisite intent of that offense,"<sup>39</sup> and even in criminal cases, recklessness can suffice to establish liability for aiding and abetting a

<sup>39</sup> *United States v. Roan Eagle*, 867 F.2d 436, 445 (8th Cir.) (rejecting arguments that aiding and abetting murder necessarily requires a showing of specific intent), *cert. denied*, 490 U.S. 1028 (1989); see *United States v. Holland*, 831 F.2d 717, 719-20 (7th Cir. 1987); *United States v. Beck*, 615 F.2d 441, 450-51 (7th Cir. 1980); *United States v. Burkhalter*, 583 F.2d 389, 391-92 (8th Cir. 1978).



statutory offense.<sup>40</sup> Because aiding and abetting securities fraud is a deceptive practice that violates § 10(b), *see supra* at 1-17, it would be illogical to require a greater showing of scienter than the recklessness which generally satisfies the knowledge or intent requirement of § 10(b).

A serious difficulty with a higher scienter standard for aiding and abetting is the lack of any clear distinction between primary violations and aiding and abetting. If an accountant actively assists in a company's unlawful sale of securities, is he a primary violator or an aider and abettor? If different standards of scienter are applied to aiders and abettors, this collateral issue will be fought in each case, with artificial distinctions proposed and debated. Similarly, if different scienter standards apply depending upon whether those who assist the execution of fraud possessed a pre-existing "duty" to speak or act, courts will be embroiled in needless debates to define the existence and scope of such duties.

There is no reason to embroil the courts in such debates. *Everyone* possesses a duty not to perpetrate, or to assist in the perpetration of, securities fraud. One who makes a statement with a conscious indifference to its truth or falsity, or who aids and abets another with a reckless disregard to whether investors are misled and defrauded, acts in a knowingly deceptive fashion and should not escape liability for his or her dishonest conduct – whether or not he (or she) has breached some other duty as well.

### 1. Reckless Conduct Establishes Intent To Defraud

In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), this Court observed that "[i]n certain areas of the law

<sup>40</sup> *See, e.g., United States v. Hughes*, 891 F.2d 597, 601 (6th Cir. 1989) (reckless disregard sufficient to sustain conviction for aiding and abetting misapplication of federally insured bank funds); *United States v. Sarantos*, 455 F.2d 877, 880-82 (2d Cir. 1972) (sustaining attorney's conviction for recklessly aiding and abetting false representations to INS). *See John P. Freeman & Nathan M. Crystal, Scienter in Professional Liability Cases*, 42 S. C.L. Rev. 783, 839-44 (1991).

recklessness is considered to be a form of intentional conduct." *Hochfelder*, 425 U.S. at 194 n.12; *see Rolf*, 570 F.2d at 45 n.12. *The law of fraud is one of those areas.*

In the criminal law, "[f]raudulent intent is shown if a representation is made with reckless indifference to its truth or falsity." *United States v. Cusino*, 694 F.2d 185, 187 (9th Cir. 1982), *cert. denied*, 461 U.S. 932 (1983) (citation omitted). The circuit courts therefore "have repeatedly held that reckless indifference alone will support a mail fraud conviction,"<sup>41</sup> and recklessness is sufficient to establish criminal intent to defraud under the securities statutes.<sup>42</sup> Recklessness also

<sup>41</sup> *United States v. Gay*, 967 F.2d 322, 326 (9th Cir.), *cert. denied*, 113 S. Ct. 359 (1992) (citation omitted); *see, e.g., United States v. Amrep Corp.*, 560 F.2d 539, 543-44 (2d Cir. 1977), *cert. denied*, 434 U.S. 1015 (1978); *Bentel v. United States*, 13 F.2d 327, 329 (2d Cir.), *cert. denied*, 273 U.S. 713 (1926); *United States v. Boyer*, 694 F.2d 58, 59 (3d Cir. 1982) ("specific intent to deceive could be found from material misstatement of fact made with reckless disregard of the facts"); *United States v. Frick*, 588 F.2d 531, 536 (5th Cir.), *cert. denied*, 441 U.S. 913 (1979); *United States v. Hathaway*, 798 F.2d 902, 909 (6th Cir. 1986); *United States v. Henderson*, 446 F.2d 960, 966 (8th Cir.), *cert. denied*, 404 U.S. 991 (1971); *United States v. Themy*, 624 F.2d 963, 965 (10th Cir. 1980) ("indifference to the truth of statements made to induce others to action amounts to fraudulent intent"); *Irwin v. United States*, 338 F.2d 770, 774 (9th Cir. 1964), *cert. denied*, 381 U.S. 911 & 919 (1965); *United States v. Sawyer*, 799 F.2d 1494, 1502 (11th Cir. 1986), *cert. denied*, 479 U.S. 1069 (1987). The same rule applies in civil RICO actions based on criminal mail fraud. *See, e.g., O'Malley v. New York City Transit Authority*, 896 F.2d 704, 706 (2d Cir. 1990); *In re Phillips Petroleum Sec. Litig.*, 881 F.2d 1236 (3d Cir. 1989); *Diamonds Plus, Inc. v. Kolber*, 960 F.2d 765, 768 (8th Cir. 1992).

<sup>42</sup> *See, e.g., Boyer*, 694 F.2d at 59-60 (§ 10(b) violation); *United States v. Farris*, 614 F.2d 634, 638 (9th Cir. 1979) (§ 17(a) violation), *cert. denied*, 447 U.S. 926 (1980); *United States v. Weiner*, 578 F.2d 757, 786-87 (9th Cir.) (§§ 6, 17 & 13 violations), *cert. denied*, 439 U.S. 981 (1978); *United States v. Natelli*, 527 F.2d 311, 323 (2d Cir. 1975) (§ 14 violation), *cert. denied*, 425 U.S. 934 (1976). Recklessness also suffices to establish scienter for violations of state law securities regulations



suffices to establish civil liability for fraud. *Equitable Life Ins. Co. v. Halsey, Stuart & Co.*, 312 U.S. 410, 420-21 (1941) (Iowa law).

"At common law reckless behavior was sufficient to support causes of action sounding in fraud or deceit." *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1044 (7th Cir.), cert. denied, 434 U.S. 875 (1977); see *Rolf*, 570 F.2d at 46. The common law decisions are, indeed, virtually unanimous in holding that recklessness satisfies the requirement of fraudulent intent.<sup>43</sup>

"Fraud is proved when it is shown that the false representation was made knowingly, or in conscious ignorance of the truth, or recklessly, without caring whether it be true or false." *Warren Balderston Co. v. Integrity Trust Co.*, 314 Pa. 58, 60, 170 A. 282, 283 (1934). "Fraud includes the pretense of knowledge when knowledge there is none." *Ultramares Corp. v. Touche*, 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931) (Cardozo, J.). Thus, "[a]

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patterned after § 10(b). See, e.g., *State v. Hynds*, 84 Wash. 2d 657, 663-64 & nn. 1-2, 529 P.2d 829 (1974).

<sup>43</sup> With the single exception of North Carolina, every American state has concluded that recklessness supplies the necessary fraudulent intent for common law fraud. See Kevin R. Johnson, *Liability for Reckless Misrepresentations and Omissions Under Section 10(b) of the Securities Exchange Act of 1934*, 59 U. Cin. L. Rev. 667, 700-06 (1991). The rule was firmly established in the English common law. "[I]n an action of deceit the representation to found the action *must not be innocent*, that is to say, it must be made either with knowledge of its being false, or with a *reckless disregard* as to whether it is or is not true." *Arkwright v. Newbold*, 17 Ch.D. 301, 320 (1881) (Cotton, L.J.) (emphasis added). "[F]raud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) *recklessly, careless whether it be true or false*." *Derry v. Peek*, 14 App. Cas. 337, 374 (H.L. 1889) (Lord Herschell) (emphasis added). If the American common law differs from English law, it is because our law gives an even wider scope to the recklessness that will satisfy the element of fraudulent intent. See, e.g., *Schlechter v. Felton*, 134 Minn. 143, 146-47, 158 N.W. 813, 814-15 (1916); see also Freeman & Crystal, *supra* note 40, at 790-91.

representation certified as true to the knowledge of the [defendants] when knowledge there is none, a reckless misstatement, or an opinion based on grounds so flimsy as to lead to the conclusion that there was no genuine belief in its truth, are all sufficient upon which to base liability." *State Street Trust Co. v. Ernst*, 278 N.Y. 104, 112, 15 N.E. 2d 416, 418-19 (1938).

This Court's own precedents concur with the common law's recognition that reckless disregard – or the making of statements with no sufficient basis – can satisfy the requirement of intent to mislead. In *Cooper v. Shlesinger*, 111 U.S. 148 (1884), for example, this Court held that "the jury were properly instructed that a *statement recklessly made*, without knowledge of its truth, *was a false statement knowingly made*." *Id.* at 155 (emphasis added). In *Lehigh Zinc & Iron Co. v. Bamford*, 150 U.S. 665 (1893), this Court held that "a person who makes representations of material facts, assuming or intending to convey the impression that he has actual knowledge of the existence of such facts, when he is conscious that he has no such knowledge, is as much responsible for the injurious consequences of such representations, to one who believes and acts upon them, as if he had actual knowledge of their falsity. . . ." <sup>44</sup>

The thrust of the common law decisions is that a statement recklessly made is one not *honestly* made. "For a man who makes a statement without care and regard

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<sup>44</sup> *Lehigh Zinc*, 150 U.S. at 673. Nearly a century later, in *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2758 (1991), this Court held in a case arising under § 14(a) of the Exchange Act that public representations "in a commercial context are reasonably understood to rest on a factual basis that justifies them as accurate, the absence of which renders them misleading." Thus, a statement made with knowledge that it lacks a reasonable basis is a statement made with knowledge of its misleading character – that is, *with intent to mislead or defraud*. See *Lehigh Zinc*, 150 U.S. at 673; *Cooper*, 111 U.S. at 155.

for its truth or falsity commits a fraud. He is a rogue."<sup>45</sup> At common law recklessness is just one form of *intent to mislead*.<sup>46</sup>

There is of course no difficulty in finding the required *intent to mislead* where it appears that the speaker believes his statement to be false. Likewise, there is general agreement that *it is present when the representation is made without any belief as to its truth, or with reckless disregard whether it be true or false*. Further than this, it appears that all courts have extended it to include representations made by one who is conscious that he has no sufficient basis of information to justify them.<sup>47</sup>

<sup>45</sup> *Derry*, 14 App. Cas. at 350 (Lord Bramwell); see also *id.* at 374, 376 (Lord Herschell) (statements recklessly made are not made with a completely "honest belief" in their truth and accuracy); *O'Neill Const. Co. v. Philadelphia*, 335 Pa. 359, 364, 6 A.2d 525, 527-28 (1939) (observing that under *S. Pearson & Son, Ltd. v. Dublin Corp.*, [1907] App. Cas. 351, representations made "with a knowledge of their falsity or with reckless indifference as to whether they were true or false" cannot qualify as "honest mistakes") (emphasis added).

<sup>46</sup> "[A] representation recklessly made, without knowledge of its truth, cannot be a statement honestly believed, but, on the contrary, is regarded as a false statement knowingly made. . . . [I]n putting his statement in such form as to amount to an assertion that he has knowledge of its truth, [one] is guilty of an intentional falsehood." *Otis & Co. v. Grimes*, 97 Colo. 219, 222, 48 P.2d 788, 789 (1935) (citation omitted); see also *Kriner v. Dinger*, 297 Pa. 576, 582 147 A. 830, 832 (1929).

<sup>47</sup> W. Page Keeton, et al., *Prosser and Keeton on the Law of Torts* § 107, at 741-42 (5th ed. 1984) (emphasis added); see *Rolf*, 570 F.2d at 45 (quoting William Prosser, *Law of Torts* § 107, at 700 (4th ed. 1971)). This has been hornbook law for a long time: "[I]f a man makes a positive representation of fact, believing it to be true, without having any information or any adequate information upon which to base it, . . . he then acts, to his own knowledge, falsely." Melville M. Bigelow, *The Law of Fraud* § 3, at 62-63 (1877) (emphasis in original).

A statement recklessly made without regard to its truth or falsity, then, is one made *with a substantial intent to deceive*. A defendant is presumed to intend the natural consequences of his acts, and a natural consequence of statements recklessly made is deception.<sup>48</sup> "[H]e is as culpable as if he had willfully asserted that to be true which he absolutely knew to be false, and is equally guilty of fraud." *Otis & Co.*, 97 Colo. at 222, 48 P.2d at 789. "'[H]is mind is wicked, not because he is negligent, but because he is dishonest in not caring about the truth of his statement.'" *Schlechter*, 134 Minn. at 146, 158 N.W. at 815 (quoting *LeLievre v. Gould*, [1893] 1 Q.B. 491, 498 (Lord Bowen)).

Reckless disregard for the truth accordingly satisfies the requirement of § 10(b) that a defendant act in some sense dishonestly or with intent to defraud. In *Ernst & Ernst v. Hochfelder*, this Court observed that "[t]he words 'manipulative or deceptive' used in conjunction with 'device or contrivance' " in § 10(b), "strongly suggest that § 10(b) was intended to proscribe *knowing or intentional* misconduct." 425 U.S. at 197 (emphasis added). Reckless conduct is a form of *knowing or intentional* conduct in the law of fraud, see *Cooper*, 111 U.S. at 155; *Rolf*, 570 F.2d at 45, and reckless conduct that foreseeably misleads investors, or that substantially assists the perpetration of fraud, is *dishonest conduct*. Thus it is no surprise that since *Hochfelder* every circuit court to consider the issue has concluded that recklessness can satisfy the scienter element for aiding and abetting a § 10(b) violation.<sup>49</sup>

<sup>48</sup> See *Clafin v. Commonwealth Ins. Co.*, 110 U.S. 81, 95 (1884); *Buechin v. Ogden Chrysler-Plymouth, Inc.*, 159 Ill. App. 3d 237, 247-48, 511 N.E.2d 1330, 1336 (1987); *Groves v. First National Bank*, 518 N.E.2d 819, 825 (Ind. App. 1988); *Smith v. Chadwick*, 9 App. Cas. 187, 190 (H.L. 1884) (Lord Selbourne).

<sup>49</sup> See, e.g., *Rolf*, 570 F.2d at 44-47; *Monsen*, 579 F.2d at 799; *Gould v. American-Hawaiian Steamship Co.*, 535 F.2d 761, 780 (3d Cir. 1976); *Schatz v. Rosenberg*, 943 F.2d 485, 496 (4th Cir. 1991), cert. denied, 112 S. Ct. 1475 (1992); *Broad v. Rockwell International Corp.*, 642 F.2d 929,



This is no time to change the law. This Court has repeatedly recognized that "an important purpose of the federal securities laws was to rectify perceived deficiencies in the available common-law protections by establishing higher standards of conduct in the securities industry." *Herman & MacLean v. Huddleston*, 459 U.S. at 389. It would "be highly inappropriate to construe the Rule 10b-5 remedy to be more restrictive than its common law analogs." *Sundstrand*, 553 F.2d at 1044 (footnote omitted).

## 2. One Who Is Under No "Duty" To Speak Or To Act Still Is Under A Duty Not To Recklessly Aid And Abet Perpetration Of Fraud

Petitioner contends that liability may not be imposed for recklessly aiding and abetting fraud "where there is no breach of a duty to disclose or to act," but its argument confuses the fundamental issues.

Absent some duty to speak, of course, pure silence or inaction cannot be misleading.<sup>50</sup> Therefore, where a securities fraud action is predicated on a defendant's silence, there is no fraud absent a duty to speak.<sup>51</sup> Absence of a duty to speak or to act, however, does not protect those who choose to speak from liability for fraud. To the contrary, "Rule 10b-5 is violated whenever assertions are made . . . in a manner reasonably calculated to influence the investing public . . . if such assertions are false or

961-62 (5th Cir.) (en banc), cert. denied, 454 U.S. 965 (1981); *Herm v. Stafford*, 663 F.2d at 684; *K & S Partnership v. Continental Bank, N.A.*, 952 F.2d 971, 978 (8th Cir. 1991), cert. denied, 112 S. Ct. 2993 (1992); *FDIC v. First Interstate Bank*, 885 F.2d at 432-3; *Levine v. Diamanthuset, Inc.*, 950 F.2d 1478, 1483 nn.4-5 (9th Cir. 1991); *Little*, 650 F.2d at 218; *First Interstate Bank*, 969 F.2d at 903; *Woods*, 765 F.2d at 1011.

<sup>50</sup> "Silence, absent a duty to disclose, is not misleading under Rule 10b-5." *Basic Inc.*, 485 U.S. at 239 n.17.

<sup>51</sup> See, e.g., *Dirks v. SEC*, 463 U.S. 646, 654 (1983); *Chiarella v. United States*, 445 U.S. 222, 235 (1980).

misleading or are so incomplete as to mislead. . . ."<sup>52</sup> This means that one who is under no duty to say anything at all still is under a duty not to mislead investors – a duty to speak the whole truth – if he does choose to speak.<sup>53</sup>

The principle applies whether the charge is a "primary" violation or aiding and abetting. Liability for aiding and abetting has always been founded upon the fact that "[a] citizen has no right to aid in breaking the laws of his country, and is bound alike in law and morals to abandon all service for another the moment he has good reason to believe his business is carried on in disregard of them." *Harbison*, 26 F. Cas. at 130.

It is a mistake to think that the duty to refrain from fraud, or from aiding and abetting fraud, must be found in the terms of an indenture of trust or other fiduciary relationship – as the petitioner appears to contend. The duty of a citizen to avoid aiding and abetting fraud applies without regard to petitioner's status as a fiduciary or its obligations as set forth in any trust indenture. See *Aaron*, 446 U.S. at 694-95 (§ 10(b) applies to nonfiduciary transactions as well as to fiduciary transactions).

Of course, the existence and breach of a fiduciary relationship, or other duty to speak or to act, may be relevant *as evidence* that a defendant aided and abetted fraud.<sup>54</sup> Absence of a fiduciary relationship does not entitle

<sup>52</sup> *Basic Inc.*, 485 U.S. at 235 n.13. (quoting *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 862 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969)).

<sup>53</sup> See *First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1317 (5th Cir. 1977), cert. denied, 439 U.S. 952 (1978); 37 *Am. Jur. 2d*, *Fraud & Deceit* § 151, at 209 & n.1 (1968).

<sup>54</sup> Breach of such a duty may constitute substantial assistance to a scheme to defraud. It also may support a finding that the defendant acted recklessly. The conduct to be expected of a given defendant always depends upon his or her circumstances and training. Just as a reasonable doctor may be expected to act



anyone to perpetrate – or to aid and abet the perpetration of – a fraud. Conscious indifference to whether one's statements are misleading – or to whether one is rendering substantial assistance to fraud – sufficed to establish liability at common law and it should suffice under § 10(b).

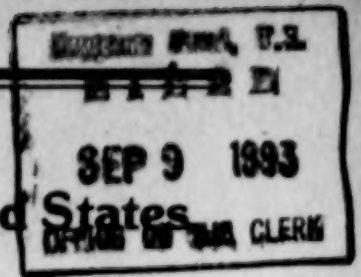
#### IV. CONCLUSION

For nearly half a century there has been an implied right of action under § 10(b) against aiders and abettors. For more than a century recklessness has been held to be a form of fraudulent intent. This Court should reject the petitioner's request to rewrite the law of securities fraud.

DATED: September 9, 1993    Respectfully submitted,  
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differently than a reasonable layman, so an accountant or underwriter's conduct may be evaluated in light of his or her training and responsibility. Keeton, et al., *Prosser and Keeton on the Law of Torts* § 32, at 185. The accountant's position of public trust, the underwriter's special knowledge and expertise regarding securities and finance, the corporate officer's unique knowledge of his company and role as representative of stockholders – all may be relevant to whether such a person acted reasonably, unreasonably, or recklessly under the circumstances. That does not mean that a special legal standard of negligence or recklessness should be created for every case, or that only fiduciaries can recklessly aid and abet a fraud. See Kuehnle, *supra* note 34 at 327-330; Don J. McDermott, Jr., Note, *Liability for Aiding and Abetting Violations of Rule 10b-5: The Recklessness Standard in Civil Damages Actions*, 62 Tex. L. Rev. 1087, 1108-1114 (1984).



IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1993

CENTRAL BANK OF DENVER, N.A.,  
*Petitioner,*

v.

FIRST INTERSTATE BANK OF DENVER, N.A.,  
and JACK K. NABER,  
*Respondents.*

ON WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS  
FOR THE TENTH CIRCUIT

**BRIEF AMICUS CURIAE OF THE ASSOCIATION  
OF THE BAR OF THE CITY OF NEW YORK  
IN SUPPORT OF RESPONDENTS**

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No. 92-854

## In the SUPREME COURT OF THE UNITED STATES

October Term, 1993

Central Bank of Denver, N.A.,

*Petitioner,*

v.

First Interstate Bank of Denver, N.A., and Jack K. Naber,

*Respondents.*

On Writ of Certiorari to the  
United States Court of Appeals  
for the Tenth Circuit

## BRIEF AMICUS CURIAE OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK IN SUPPORT OF RESPONDENTS

## QUESTIONS PRESENTED

*Amicus curiae* will address the following questions:

1. Whether there is an implied private right of action for aiding and abetting violations of §10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5.
2. Whether recklessness is an appropriate standard upon which to predicate liability for aiding and abetting violations of §10(b) and Rule 10b-5.



## INTEREST OF AMICUS CURIAE<sup>1</sup>

*Amicus Curiae* The Association of the Bar of the City of New York (the "Association of the Bar") has a great interest in the questions presented in this case. The Association of the Bar is a professional organization of approximately 19,000 lawyers, located largely in New York City but including members located throughout the United States and in over forty other countries. Since its inception in 1870, the Association of the Bar has been dedicated to the preservation and advancement of the rule of law and the fair administration of justice. The scope of the Association of the Bar's concern with justice has not been limited to the confines of the City of New York but has extended throughout the nation.

As a bar group located in New York City, however, the Association of the Bar has a special interest in securities related issues. Since the Association of the Bar's founding, New York City has been the center of the nation's capital markets, and particularly its securities markets. The New York Stock Exchange and the American Stock Exchange are located in New York City, and most major broker-dealers are headquartered in and around New York City. A large percentage of the nation's lawyers who specialize in the practice of securities law are members of the Association of the Bar. Accordingly, the Association of the Bar has both special expertise and a special interest in the important issues of securities law that are presented in this case.

## SUMMARY OF ARGUMENT

This case presents issues of the utmost importance for the protection of public investors from fraud in connection with publicly traded securities. Since 1939, in enforcement actions

<sup>1</sup> The parties have consented to the filing of this brief. Letters of consent are on file with the Clerk of the Court, pursuant to Rule 37.3 of the Rules of this Court.

by the Securities and Exchange Commission ("SEC"), and at least since 1966 in private civil actions under Section 10(b) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), aiding and abetting liability has been universally accepted by the lower courts. These courts have acknowledged that such liability is required to impose an appropriate standard of diligence and care on professionals such as attorneys and accountants, without whose assistance many financial frauds could not be perpetrated. Without aiding and abetting liability (*i.e.*, liability for intentional or reckless substantial assistance in securities fraud), it would be difficult or impossible to protect fully public investors by holding these professionals accountable for misdeeds which result in financial losses to such investors. Congress has long been aware of the law fashioned by the lower courts with respect to aiding and abetting liability and has repeatedly reflected its approval of the current legal standards.

Aiding and abetting liability is an integral element of the fabric of liability for fraud, not some recent addition to that fabric. Early in this century, great jurists routinely held that secondary violators could be held accountable for their substantial assistance to fraud.<sup>2</sup> Only last term, in *Musick, Peeler & Garrett v. Employers Ins. of Wausau*,<sup>3</sup> one of the defendants against whom this Court recognized a right to contribution was a law firm that could only have been held liable under the federal securities laws as an aider and abetter. This Court described this law firm's aiding and abetting liability as "a wrong that courts have already deemed actionable under federal law."<sup>4</sup> This language, and the Court's holding, reflect the degree to which aiding and abetting liability is universally assumed to be part of the remedy for fraud.

<sup>2</sup> See, e.g., *Ultramares Corp. v. Touche*, 255 N.Y. 170, 186 (1931) (Cardozo, J.).

<sup>3</sup> 113 S. Ct. 2085, 2089 (1993).

<sup>4</sup> *Id.* at 2088.

As an organization of attorneys, the Association of the Bar is, of course, sensitive to the issue of lawyers' exposure to large damage claims. But it is also concerned about creating proper incentives for professionals and other persons involved in securities markets and it is particularly concerned with maintaining the integrity of the Bar. A system that creates proper incentives for securities lawyers to exercise due care -- and avoid recklessness or intentional misconduct -- in securities transactions serves the interest of attorneys who are committed to performing their responsibilities in a professional and ethical manner, as well as the interest of their clients and those who rely on their clients. The Association of the Bar believes that securities lawyers, like accountants and other professionals, are fundamentally important to the process of offering and trading securities in impersonal complex markets. Public confidence in such professionals is essential to a sound securities market system. Enforcement of the securities laws against transgressor professionals thus both serves the public and the best interests of the Bar.

### ARGUMENT

The federal securities laws were enacted in the wake of the economic chaos and monumental losses that resulted from the stock market crash of 1929. Speaking in 1933, Representative Sam Rayburn, a sponsor of the Securities Act of 1933, summarized the historical background against which that statute was enacted:

During the last 12 years, an era that is falsely designated as one of prosperity, [the] American people lost perhaps a hundred billion dollars through the purchase of stocks and bonds. This catastrophe [is] so colossal as to stagger the imagination.<sup>5</sup>

<sup>5</sup> 77 Cong. Rec. H-2918 (May 5, 1933).

Congressional hearings during the 1930's exposed an extraordinary variety of frauds, market manipulations, and outright thefts of public funds that contributed to these "staggering" investor losses.<sup>6</sup> Recent scandals on Wall Street and in the savings and loan industry emphasize the continuing need for vigorous enforcement of the anti-fraud remedies under the federal securities laws.

Investors in publicly traded securities often rely upon professionals in evaluating an investment. These professionals, such as attorneys, accountants, geologists, appraisers, engineers, and others, act as "gatekeepers," who assure the public investor of the financial integrity of the investment. Long before the adoption of the federal securities laws, courts recognized that reckless or intentional misconduct by such professionals was actionable by those who sustained damages in reliance upon the professional.<sup>7</sup>

In construing the anti-fraud provisions of the federal securities laws and their important remedial purposes, federal courts have necessarily applied ancient principles of aiding and abetting liability to hold responsible professionals whose conduct substantially assisted a primary wrongdoer, particularly where such professionals would otherwise escape liability. But for such liability, in many instances the innocent investor would be left, as a practical matter, with no remedy, or a wholly inadequate one. (See pp. 9-10 *infra*) Recognizing that elimination of aiding and abetting liability would seriously weaken the federal securities laws, Congress has repeatedly endorsed the lower courts' interpretation of the scope of Section 10(b) and assumed aiding and abetting liability. (See pp. 14-15 *infra*)

<sup>6</sup> See J. Seligman, *The Transformation of Wall Street* ch. 1 (1982).

<sup>7</sup> See, e.g., *Ultramares Corp. v. Touche*, 255 N.Y. 170 (1931).



If this Court eliminates aiding and abetting principles of liability, wrongdoing professionals would escape liability in many instances where they are now legally responsible. Such a result would hurt investor confidence in honest and diligent professionals, as well as in the securities markets, and thwart the repeatedly expressed will of Congress.

The long recognized standard of recklessness should be maintained for aiding and abetting liability, subject to the equally well established requirement that the only aiders and abettors who should be liable are those who have rendered substantial assistance to primary wrongdoers. Maintenance of the recklessness standard is essential to keep the remedy viable. The additional requirement of substantial assistance keeps the remedy balanced and fair. (See p. 19 *infra*)

## **I. THIS COURT SHOULD CONTINUE TO RECOGNIZE AN IMPLIED CAUSE OF ACTION FOR AIDING AND ABETTING LIABILITY**

### **A. Aiding and Abetting Liability Is Consistent with the Remedial Purposes of the Federal Securities Laws and Essential to Their Proper Functioning**

#### **1. The Role of Aiders and Abettors in the Commission of Securities Fraud**

This Court has repeatedly interpreted Section 10(b) flexibly and broadly.<sup>8</sup> Aiding and abetting liability has been recognized

<sup>8</sup> As this Court observed in *Superintendent of Ins. of the State of New York v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971), "[s]ince practices 'constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means . . . we do not read §10(b) . . . narrowly . . . [I]t is not 'limited to preserving the integrity of the securities markets' . . . though that purpose is included. Section 10(b) must be read flexibly, not technically and restrictively."

as necessary. Without aiding and abetting liability, many of the experts, whose technical expertise plays a crucial role in the securities markets, and on whose credibility both buyers and sellers of securities depend, would be essentially immune from liability. As Judge Henry Friendly observed with characteristic insight, in upholding the criminal conviction of a lawyer who violated Section 17(a) of the Securities Act of 1933 (a section which closely parallels the language of Rule 10b-5 under the Exchange Act):

[i]n our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar. . . . Congress . . . could not have intended that men holding themselves out as members of these ancient professions should be able to escape . . . liability on a plea of ignorance when they have shut their eyes to what was plainly to be seen or have represented a knowledge they knew they did not possess.<sup>9</sup>

The essential function of accountants in protecting the public from fraud has been explicitly recognized by this Court, which has observed that "[b]y certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client."<sup>10</sup> As a consequence of "[t]his 'public watchdog' function . . . the accountant [must]

<sup>9</sup> *United States v. Benjamin*, 328 F.2d 854, 863 (2d Cir.), *cert. denied*, 377 U.S. 953 (1964). That Judge Friendly was upholding a criminal conviction only emphasizes the argument in this brief. If accountants and lawyers can go to jail for reckless conduct which results in financial loss to innocent investors, then surely public policy requires that they compensate those investors for the damage sustained as a result of such conduct.

<sup>10</sup> *United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18 & n. 15 (1984) (emphasis in the original).



maintain total independence from the client at all times and requires complete fidelity to the public trust."<sup>11</sup> This "public watchdog" role of accountants "assures that the integrity of the securities markets will be preserved. . . . The SEC requires the filing of audited financial statements in order to obviate the fear of loss from reliance on inaccurate information, thereby encouraging public investment in the Nation's industries. It is therefore not enough that financial statements be accurate; the public must also perceive them as being accurate. Public faith in the reliability of a corporation's financial statements depends upon the public perception of the outside auditor as an independent professional."<sup>12</sup>

With respect to attorneys, the SEC has accurately explained the special role of the securities attorney because of public faith in their integrity. We agree with the SEC's recognition of "the peculiarly strategic and especially central place of the private practicing lawyer in the investment process and in the enforcement of the body of federal law aimed at keeping that process fair."<sup>13</sup> "[T]he task of enforcing the securities laws rests in overwhelming measure on the bar's shoulders."<sup>14</sup> This is because of the unique role of the securities lawyer in the preparation of documents that are required to market securities to the public: "Very little of a securities lawyer's work is adversary in character. He doesn't work in courtrooms where the pressure of vigilant adversaries and alert judges checks him. He works in his office where he prepares prospectuses, proxy statements, opinions of counsel, and other documents that we [at the SEC], our staff, the financial community and the investing public must

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *In re Emanuel Fields*, 45 S.E.C. 262, 266 n.20 (1973), *aff'd without opinion*, 495 F.2d 1075 (D.C. Cir. 1974).

<sup>14</sup> *Id.*

take on faith. This is a field where unscrupulous lawyers can inflict irreparable harm on those who rely on the disclosure documents that they produce."<sup>15</sup>

Similar gatekeeping functions are performed by other experts, such as geologists, appraisers, engineers, actuaries, and rating agencies. The integrity and reputations of these professionals are relied upon by the public to ensure that material representations made in connection with securities transactions are accurate and not misleading. The technical expertise of those professionals, however, is frequently an essential ingredient in the commission of securities fraud.

## 2. The Need for Aiding and Abetting Liability

Section 10(b) has long been the most effective means for private plaintiffs to obtain relief for securities fraud. A plaintiff may not be able to bring a primary liability claim under Section 10(b) against the accountants, lawyers, and other professionals who knowingly or recklessly assist a fraud. These professionals often fail to participate directly in the sale of the securities and most often lack any fiduciary relationship with the plaintiff. Moreover, the control person liability does not usually apply.<sup>16</sup> Seldom can a plaintiff claim that the accountants, lawyers, or other professionals actually controlled the transaction. Nor can a plaintiff often sue these defendants under Section 12 of the Securities Act, which applies to sellers, because the accountants, lawyers, and other professionals typically fail to participate directly in the sale of securities.<sup>17</sup>

The aiding and abetting theory permits Section 10(b) to be applied to fraudulent conduct by defendants who were

<sup>15</sup> *Id.*

<sup>16</sup> 15 U.S.C. § 78t(a); 15 U.S.C. § 77o.

<sup>17</sup> *Pinter v. Dahl*, 486 U.S. 622 (1988).

instrumental in causing the fraud, even though they neither sold the securities nor had any contact with the plaintiff.

## **B. Principles of Statutory Construction Support an Implied Private Right of Action for Aiding and Abetting Liability**

### **1. Relevant Principles of Statutory Construction**

In recent years, this Court has frequently confronted the question of whether to find an implied private right of action under a federal statute. The focus of the Court's inquiry in these cases has been on the intent of the Congress. As this Court noted when it found an implied private right of action for violations of the Commodities Exchange Act, this inquiry is different when Congress legislates in an area in which courts have already found an implied private right of action:

[w]hen Congress enacts new legislation, the question is whether Congress intended to create a private remedy as a supplement to the express enforcement provisions of the statute. When Congress acts in a statutory context in which an implied private remedy has already been recognized by the courts, however, the inquiry logically is different. Congress need not have intended to create a new remedy, since one already existed; *the question is whether Congress intended to preserve the pre-existing remedy.*<sup>18</sup>

This Court applied similar reasoning to find an implied private right of action under Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder. This Court relied principally upon Congressional action in amending the Exchange Act in

<sup>18</sup> *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 378-79 (1982)(emphasis added).

1975 with an awareness that numerous lower courts had found an implied private right of action under Section 10(b) and Rule 10b-5:

when Congress comprehensively revised the securities laws in 1975, a consistent line of judicial decisions had permitted plaintiffs to sue under § 10(b) regardless of the availability of express remedies. . . . When Congress acted, federal courts had consistently and routinely permitted a plaintiff to proceed under § 10(b) even where express remedies under § 11 or other provisions were available. In light of this well-established judicial interpretation, Congress' decision to leave § 10(b) intact suggests that Congress ratified the cumulative nature of the § 10(b) action.<sup>19</sup>

Thus, the test for determining whether Congress intended to recognize an implied private right of action for aiding and abetting liability depends on whether Congress amended the Exchange Act after the lower courts had consistently recognized such an implied private right of action and left that implied right of action untouched. Here, that test has clearly been met.

### **2. Aiding and Abetting Liability Has Long Been Accepted by the Lower Courts and Congress Has Acted in this Context**

The doctrine of aiding and abetting liability was first recognized in a civil action under the federal securities laws in a case brought by the SEC.<sup>20</sup> In that case, where the SEC alleged violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), the anti-fraud prohibition under that statute,

<sup>19</sup> *Herman & MacLean v. Huddleston*, 459 U.S. 375, 384-86 (1983).

<sup>20</sup> *SEC v. Timetrust, Inc.*, 28 F. Supp. 34 (N.D. Cal. 1939).



the court accepted the doctrine of aiding and abetting by analogy to the criminal law concept.<sup>21</sup> The SEC also applied the doctrine of aiding and abetting liability in its administrative proceedings, before the Exchange Act was amended to create express liability for aiding and abetting in these proceedings.<sup>22</sup>

Liability premised on aiding and abetting was first recognized in a private civil action under the federal securities laws in 1966.<sup>23</sup> The court in that case relied upon the formulation of aiding and abetting liability set forth in the Restatement of Torts:

For harm resulting to a third person from the tortious conduct of another, a person is subject to liability if he . . . knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself. . . .<sup>24</sup>

<sup>21</sup> "Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal." 18 U.S.C. § 2(a).

<sup>22</sup> See, e.g., *Burley & Co.*, 23 S.E.C. 461, 463-64, 467-68 & n.11 (1946).

<sup>23</sup> *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673, 676-77 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).

<sup>24</sup> *Restatement of Torts* § 876(b) (1939). The *Restatement (Second) of Torts* contains the same language, noting the numerous Rule 10b-5 cases that have invoked it. See § 876(b) (1979) and App. § 876 (1982 & Supp. 1988).

The doctrine of aiding and abetting liability was recognized in tort law long before the First Restatement. See T. Cooley, *A Treatise of the Law of Torts* 244 (3d ed. 1906) ("All who actively participate in any manner in the commission of a tort, or who command, direct, advise, encourage, aid or abet its commission are jointly and severally liable therefor.").

Following *Brennan*, every federal court that has considered the question has found aiding and abetting liability in private actions under the federal securities laws.<sup>25</sup>

<sup>25</sup> *First Circuit: Cleary v. Perfectune, Inc.*, 700 F.2d 774 (1st Cir. 1983).

*Second Circuit: IIT v. Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980); *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47-48 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978); *Hirsch v. du Pont*, 553 F.2d 750, 759 (2d Cir. 1977).

*Third Circuit: Healey v. Catalyst Recovery of Pennsylvania, Inc.*, 616 F.2d 641, 651 (3d Cir. 1980); *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 799 (3d Cir.), *cert. denied*, 439 U.S. 930 (1978); *Gould v. American-Hawaiian S.S. Co.*, 535 F.2d 761, 779 (3d Cir. 1976); *Landy v. FDIC*, 486 F.2d 139, 163 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

*Fourth Circuit: Schatz v. Rosenberg*, 943 F.2d 485 (4th Cir. 1991), *cert. denied*, 112 S.Ct. 1475 (1992).

*Fifth Circuit: Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 94-95 (5th Cir. 1975).

*Sixth Circuit: SEC v. Washington County Util. Dist.*, 676 F.2d 218, 223-27 (6th Cir. 1982); *SEC v. Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975).

*Seventh Circuit: Hochfelder v. Midwest Stock Exch.*, 503 F.2d 364, 374 (7th Cir.), *cert. denied*, 419 U.S. 875 (1974).

*Eighth Circuit: Stokes v. Loken*, 644 F.2d 779, 782-83 (8th Cir. 1981).

*Ninth Circuit: Strong v. France*, 474 F.2d 747, 752 (9th Cir. 1973).

*Tenth Circuit: Kerbs v. Fall River Indus., Inc.*, 502 F.2d 731, 740 (10th Cir. 1974).

*Eleventh Circuit: Woods v. Barnett Bank*, 765 F.2d 1004 (11th Cir. 1985).

District of Columbia: The District of Columbia has not considered the question in private actions, but has found aiding and abetting liability in actions brought by the SEC. See *SEC v. Falstaff Brewing Corp.*, 629 F.2d 62, 72 (D.C. Cir.), *cert. denied*, 449 U.S. 1012 (1980); *Investors Research Corp. v. SEC*, 628 F.2d 168, 177 (D.C. Cir.), *cert. denied*, 449 U.S. 919 (1980).



That there is civil liability for aiding and abetting a violation of Rule 10b-5 was so widely acknowledged that the petitioners themselves failed to seek review of that issue. In addition this Court itself has implicitly assumed the existence of such liability. In *Musick, Peeler*, this Court held that there was a right of contribution against attorneys and accountants "based on the 10b-5 action central to the complaint."<sup>26</sup> The only theory on which liability under Rule 10b-5 could be asserted against nonsettling lawyers and accountants would be aiding and abetting. It is reasonable to assume that this Court would not have decided a wholly hypothetical issue of contribution if there were no underlying basis for asserting liability against the non-settling parties.

This pattern of universal recognition of an implied private right of action for aiding and abetting liability parallels exactly the pattern that persuaded this Court in *Huddleston* to recognize an implied private right of action for violations of Section 10(b). As this Court noted in *Huddleston*, "[i]n 1975 Congress enacted the 'most substantial and significant revision of this country's Federal securities laws since the passage of the Securities Exchange Act in 1934.' . . . Congress' decision to leave § 10(b) intact suggests that Congress ratified the cumulative nature of the § 10(b) action."<sup>27</sup>

Thus, it is clear that under the test this Court applied in *Curran* and *Huddleston*, Congressional intent supports the recognition of an implied private right of action against those who aided and abetted a securities fraud in violation of Rule 10b-5.

### 3. Congress Itself Has Recognized the Propriety of Aiding and Abetting Liability

In the case of aiding and abetting liability, the case for Congressional recognition of this remedy is even stronger than in

<sup>26</sup> *Musick*, 113 S. Ct. at 2086-87.

<sup>27</sup> *Huddleston*, 459 U.S. at 385-86.

*Huddleston* itself. Twice Congress has expressly acknowledged and approved the existence of this remedy. First, in 1983, a Congressional report on the Insider Trading Sanctions Act of 1984 endorsed "the judicial application of aiding and abetting liability to achieve the remedial purposes of the securities laws."<sup>28</sup> Similarly, in a 1988 report on the Insider Trading and Securities Fraud Enforcement Act of 1988, Congress noted that, although the express private right of action created by that statute precludes suits based on the theory of *respondent superior*, it "does not affect the availability of any other theories of liability, such as aiding and abetting . . . in appropriate circumstances."<sup>29</sup>

Only last term, this Court observed that recent Congressional action in adopting the Insider Trading and Securities Fraud Enforcement Act of 1988 and the legislation respecting limitations periods for Rule 10b-5 actions reflects "an acknowledgement of the 10b-5 action without any further expression of legislative intent to define it."<sup>30</sup> This Court also noted that "the caution in" Congress's limitation on the retroactive effect of the *Lampf*<sup>31</sup> decision "is instructive."<sup>32</sup> Essentially, Congress has sent a message that it approves of the current state of the law with respect to Section 10(b) liability. Fidelity to the current standards of liability is thus consistent with Congressional intent.

<sup>28</sup> H.R. Rep. 355, 98th Cong., 2d Sess. 10 (1983)(citing *SEC v. Coven*, 581 F.2d 1020, 1028 (2d Cir. 1978), *cert. denied*, 440 U.S. 950 (1979) and *Rolf v. Bythe, Eastman Dillon & Co.*, 570 F.2d 38 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978)).

<sup>29</sup> H.R. Rep. No. 910, 100th Cong., 2d Sess. 27-28 n. 23.

<sup>30</sup> *Musick*, 113 S. Ct. at 2089.

<sup>31</sup> *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773 (1991).

<sup>32</sup> *Musick*, 113 S. Ct. at 2089.

## II. THE RECKLESSNESS STANDARD IS APPROPRIATE FOR AIDING AND ABETTING LIABILITY

### A. Background: The Meaning of Recklessness

Most courts have applied the following definition of recklessness in the context of aiding and abetting liability:

[R]eckless conduct may be defined as a highly unreasonable [act or] omission, involving not merely simple, or even inexcusable, negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.<sup>33</sup>

This definition is consistent with the definitions of reckless conduct in the *Restatement (Second) of Torts*,<sup>34</sup> and the Model Penal Code.<sup>35</sup> It is also consistent with standards applied for

<sup>33</sup> *Franke v. Midwestern Oklahoma Dev. Auth.*, 428 F. Supp. 719, 725 (W.D. Okla. 1976), *vacated on other grounds*, 619 F.2d 856 (10th Cir. 1980). See, e.g., *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033 (7th Cir.), *cert. denied sub nom., Meers v. Sundstrand Corp.*, 434 U.S. 875 (1977)(quoting *Franke*).

<sup>34</sup> § 526: "A misrepresentation is fraudulent if the maker (a) knows or believes that the matter is not as he represents it to be, (b) does not have the confidence in the accuracy of his representation that he states or implies, or (c) knows that he does not have the basis for his representation that he states or implies."

<sup>35</sup> § 2.02(c): "A person acts recklessly with respect to a material element of an offense when he consciously disregards a substantial and unjustifiable risk that the material element exists or will result from his conduct. The risk must be of such a nature and degree that, considering the nature and purpose of the actor's conduct and the circumstances known to him, its disregard involves a gross deviation from the standard of conduct that a law-abiding person would observe in the actor's situation."

generations in common-law actions for fraud. As a court observed almost sixty years ago in holding an accountant liable for fraud:

[a] representation certified as true to the knowledge of the accountants when knowledge there is none, a reckless misstatement, or an opinion based on grounds so flimsy as to lead to the conclusion that there was no genuine belief in its truth, are all sufficient upon which to base liability. A refusal to see the obvious, a failure to investigate the doubtful, if sufficiently gross, may furnish evidence leading to an inference of fraud so as to impose liability for losses suffered by those who rely on the balance sheet. In other words, heedlessness and reckless disregard of consequence may take the place of deliberate intention.<sup>36</sup>

### B. The Current Recklessness Standard for Aiding and Abetting Liability Is Consistent with the Remedial Purposes of the Federal Securities Laws

Application of a recklessness standard for aiding and abetting liability serves the broad remedial purposes of the federal securities laws. As explained above, aiding and abetting liability is the principal theory available to hold attorneys, accountants and other professionals accountable for wrongdoing under the federal securities laws. These professionals, the gatekeepers of the securities markets, can, by fulfilling the responsibilities they

<sup>36</sup> *State Street Trust Co. v. Ernst*, 278 N.Y. 104, 112 (1938). See also *Ultramares Corp. v. Touche*, 255 N.Y. 170, 186 (1931) (Cardozo, J.) ("Even an opinion, especially an opinion by an expert, may be found to be fraudulent if the grounds supporting it are so flimsy as to lead to the conclusion that there was no genuine belief back of it.")



assumed protect the public from fraud, while by their indifference to such responsibilities they can inflict enormous pecuniary loss on the public.

The recklessness standard of *scienter* creates the right incentives for these professionals. When they become aware of warnings of possible fraud, the recklessness standard requires them to inquire further and to satisfy themselves that a fraud is not occurring. On the other hand, they are not exposed to liability for mere negligence; such a standard would be unfair and impose too great a risk on professionals. This is essentially the formulation enumerated by Judge Cardozo more than sixty years ago.<sup>37</sup> It was sound then and it remains sound now.

A standard that requires proof of actual knowledge rather than recklessness would disrupt this proper balance of incentives. For example, if an attorney could be held liable only if he or she had actual knowledge of the fraud, a lawyer would have every incentive to merely ignore a red flag suggesting fraud. To paraphrase Judge Friendly, shutting his eyes -- deliberately ignoring his professional responsibility -- would actually shield him from exposure to financial losses because his conduct was only reckless. Thus, requiring proof of intentional misconduct would create an incentive for attorneys, accountants, and other professionals to play a passive role in securities transactions. Such a standard would not only lead to less trustworthy securities markets, but would also frustrate the purposes of the federal securities laws and undermine the protection otherwise afforded by aiding and abetting liability.

Perhaps yet another reason why judges as wise as Cardozo and Friendly equated recklessness with intentional conduct in the case of fraud by a professional is the difficulty in proving intentional conduct in such circumstances. Rarely will there be a confession or admission by another party that the professional

<sup>37</sup> *Ultramares Corp. v. Touche*, 255 N.Y. 170.

was aware of the fraud. Indeed, questions of privilege could heavily burden inquiries into the professional's relevant knowledge. A recklessness standard provides an objective basis for determining that in fact the professional knew of the fraud or, in an extreme violation of professional standards, chose not to know.

### C. The Substantial Assistance Requirement for Aiding and Abetting Liability Affords a Proper Balance When Coupled with the Recklessness Standard

In arguing for a relaxed standard of conduct, the petitioners and the *amici* supporting the petitioners express concern that a recklessness standard would impose greater liability on those who had a "remote link to a securities transaction than against a principal participant...."<sup>38</sup> This argument ignores the requirement that an aider and abettor render substantial assistance to the principal. The contours and definition of the substantial assistance requirement have been shaped by innumerable decisions in lower federal courts. While the issue is not now before the Court, the substantial assistance requirement protects professionals whose connection with the transaction is remote and shields them from the parade of imaginary horrors conjured up by petitioner and *amici* supporting its position.<sup>39</sup>

<sup>38</sup> *Amicus* Brief of the Securities Industry Association at p. 28.

<sup>39</sup> In addition, under *Musick*, 113 S. Ct. 2085, a party with such secondary liability has the right to seek contribution from primary wrongdoers.



**SUMMARY AND CONCLUSION**

The preservation of the civil remedy for persons damaged by those who aid and abet a securities fraud is essential to the effectiveness of the federal securities laws and fully consistent with the public policies of the statute as endorsed by this Court. Congress has acknowledged the importance of the remedy. Recklessness is the only appropriate scienter requirement in such a case. Accordingly, the decision below should be affirmed.

Dated: September 9, 1993  
New York, New York

Respectfully submitted,

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No. 92-854

Supreme Court, U.S.

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**In the Supreme Court of the United States**

**OCTOBER TERM, 1993**

**CENTRAL BANK OF DENVER, N.A., PETITIONER**

*v.*

**FIRST INTERSTATE BANK OF DENVER, N.A.,  
AND JACK K. NABER**

**ON WRIT OF CERTIORARI  
TO THE UNITED STATES COURT OF APPEALS  
FOR THE TENTH CIRCUIT**

**BRIEF FOR THE SECURITIES AND  
EXCHANGE COMMISSION AS AMICUS CURIAE  
IN SUPPORT OF RESPONDENTS**

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41 pp

## **QUESTIONS PRESENTED**

1. Whether there is an implied private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and the Securities and Exchange Commission's Rule 10b-5, 17 C.F.R. 240.10b-5.

2. Whether recklessness, as opposed to conscious intent, is sufficient to satisfy the scienter element of aiding-and-abetting liability under Section 10(b) of the Securities Exchange Act, where the defendant's substantial assistance of the primary wrongdoing consists of affirmative action rather than silence and inaction.



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## In the Supreme Court of the United States

OCTOBER TERM, 1993

No. 92-854

CENTRAL BANK OF DENVER, N.A., PETITIONER

v.

FIRST INTERSTATE BANK OF DENVER, N.A.,  
AND JACK K. NABERON WRIT OF CERTIORARI  
TO THE UNITED STATES COURT OF APPEALS  
FOR THE TENTH CIRCUITBRIEF FOR THE SECURITIES AND  
EXCHANGE COMMISSION AS AMICUS CURIAE  
IN SUPPORT OF RESPONDENTSINTEREST OF THE  
SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission administers and enforces the federal securities laws. The questions presented in this case are whether there is an implied private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and the Commission's Rule 10b-5, 17 C.F.R. 240.10b-5, and, if so, whether recklessness satisfies the scienter element for such liability in the circumstances of this case. Private actions under Rule 10b-5 are an essential supplement to Commission enforcement of the Exchange Act, and the Commission has a strong interest in



seeing that the principles applied in such actions promote the purposes of the securities laws. Aiding-and-abetting liability and the recklessness standard are also critical in the Commission's own enforcement actions. The United States filed a brief in this case at the petition stage at the invitation of the Court.

### STATEMENT

Petitioner served as indenture trustee for two separate bond issues sold in 1986 and 1988 by the Colorado Springs-Stetson Hills Public Building Authority to finance public improvements to a planned community. The indenture required the bonds to be secured at all times by land having an appraised value of at least 160% of the outstanding principal and interest. Pet. App. A4-A5.

In early 1988, before the second offering, petitioner received an updated appraisal covering both the land securing the 1986 bonds and the separate parcels that were to secure the 1988 bonds. The new appraisal, prepared by the same individual who had supplied the original appraisal in 1986, showed land values essentially unchanged from 1986, even though local real estate values had declined in the interim. Pet. App. A5-A6, A7 n.6. The lead underwriter for the 1986 bonds notified petitioner that the 160% test was not being met for those bonds, and expressed concern that the 1988 appraisal was unreliable. *Id.* at A6. Petitioner's own investigation raised similar questions. *Id.* at A7.

Petitioner, as trustee for the 1986 bonds, at first directed that an independent review of the appraisal be conducted by a different appraiser. Pet. App. A7. After meetings with the issuer, the developer, and others, however, petitioner agreed to defer the independent review until late 1988, at least six months after the 1988 bonds were to be sold. As one condition for petitioner's forbearance, the developer agreed to pledge an additional \$2 million in property as security for the 1986 bonds. *Id.* at A8 & n.7. No additional property was pledged as security

for the 1988 bonds, see *id.* at A27, which were sold as scheduled in June 1988. *Id.* at A4. Thereafter the issuer refused to complete the promised independent appraisal, and ultimately defaulted on the 1988 bonds. *Id.* at A9.

Respondents are purchasers of 1988 bonds who brought this securities fraud action against petitioner and others, alleging that the 1988 sale violated Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78j(b), and the Commission's Rule 10b-5, 17 C.F.R. 240.10b-5. In particular, respondents alleged that petitioner knowingly or recklessly aided and abetted the fraud by withdrawing its demand for an immediate independent review of the appraisal despite serious concerns about its accuracy, and by agreeing to delay the review until after the 1988 bonds had been sold. Pet. App. A9, A20, A27 & n.19.

The district court granted summary judgment for petitioner. Pet. App. A29-A36. The court held that recklessness could not satisfy the scienter requirement for aiding-and-abetting liability absent an independent duty on petitioner's part to disclose information, and that there was no genuine issue of material fact as to petitioner's actual knowledge or its duty. *Id.* at A33. The court of appeals agreed (*id.* at A20) that petitioner had no duty to disclose, but held (*id.* at A25) that reckless action—as opposed to mere silence or inaction—that assists a fraud may satisfy the scienter requirement for aiding and abetting even absent such a duty. The court concluded that this case involved more than mere inaction, because petitioner “affirmatively agree[d] to delay the independent review of the [1988] appraisal.” *Id.* at A23. Given petitioner's concerns about the appraisal and its knowledge of the upcoming bond sale, the court held that petitioner's decision to allow the delay could support a finding of recklessness, and it remanded the case for trial on that issue. *Id.* at A26-A27.



## SUMMARY OF ARGUMENT

Liability for aiding and abetting is fairly encompassed within the established private cause of action under Rule 10b-5. Such liability is supported by the broad language of Section 10(b), read in its statutory and historical context. The federal courts have long and uniformly permitted private plaintiffs to sue defendants for aiding-and-abetting violations of Rule 10b-5, and the history of recent Exchange Act amendments demonstrates that Congress has approved the courts' resolution of the issue. That result is consistent with the deterrent and remedial purposes of the securities laws, and with the role of the private action as a necessary supplement to the Commission's own enforcement efforts. It should not be disturbed.

In order to establish liability for aiding and abetting, a plaintiff must generally establish that the defendant substantially assisted a third party's violation of Rule 10b-5, and did so with some degree of scienter. This case concerns only what degree of scienter is required. In our view, a recklessness standard is appropriate where the required substantial assistance is accomplished through some affirmative action on the part of the defendant, even if the defendant owes the plaintiff no independent duty.

The recklessness standard applies for purposes of primary violations of Rule 10b-5, as well as for purposes of common law fraud. In those cases it discourages deliberate ignorance and, importantly, prevents defendants from escaping liability simply because of the often prohibitive difficulty of proving knowledge or conscious intent on the basis of the circumstantial evidence frequently used in securities fraud cases. The same rationales apply equally to liability for aiding and abetting. In addition, the recklessness standard combines flexibility and predictability more effectively than the alternatives. It requires proof of a high level of culpability in order to establish liability, without limiting such liability so

severely as to impede effective public and private enforcement of the law.

## ARGUMENT

### I. AIDERS AND ABETTORS MAY BE INCLUDED AS DEFENDANTS IN A PRIVATE ACTION UNDER SECTION 10(B) AND RULE 10B-5

This Court has recently reaffirmed that private actions under Section 10(b) and Rule 10b-5 are "an accepted feature of our securities laws," and that the federal courts have appropriately "accepted and exercised the principal responsibility for the continuing elaboration of the scope" of such actions. *Musick, Peeler & Garrett v. Employers Ins.*, 113 S. Ct. 2085, 2089 (1993); see also, e.g., *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983). In prior cases involving such elaboration, this Court has looked to statutory language, legislative history, lower court decisions, statutory and common law when the Exchange Act was enacted, and policy considerations.<sup>1</sup> In this case, those factors all counsel confirmation by this Court of the lower courts' uniform conclusion that private actions may properly reach defendants who have aided or abetted violations of Rule 10b-5.

#### A. Liability For Aiding And Abetting Is Fairly Encompassed Within The Existing Private Action Under Rule 10b-5

*Musick, Peeler* reiterated this Court's recognition of judicial authority to define the contours of the existing private right of action under Rule 10b-5, and to "flesh out" aspects of the law on which the Act and implementing regulations do not offer conclusive guidance. 113 S. Ct. at

<sup>1</sup> See, e.g., *Musick, Peeler*, 113 S. Ct. at 2090-2092 (analogous provisions, lower court decisions and policy considerations); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197-206 (1976) (statutory language and legislative history); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 729-749 (1975) (statutory language, judicial treatment, common law, and policy).

2089, quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975); see also *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2764 (1991) (looking to policy considerations to evaluate "rounding out" substance of existing implied right of action). That is what the lower courts have done with respect to aider-and-abettor liability under Rule 10b-5.

In *Musick, Peeler*, this Court treated contribution rights as merely an aspect of the existing Rule 10b-5 private right of action, even though a right of contribution is typically thought to be "a separate or independent cause of action." 113 S. Ct. at 2088. The Court found the contribution action to be sufficiently aligned with the existing private right because it alleged that those from whom contribution was sought had "committed a wrong that courts have already deemed actionable under federal law." *Ibid.* Under that analysis, aider-and-abettor liability is even more clearly comprehended within the existing cause of action. As this Court has indicated in analogous contexts, for purposes of giving content to recognized private rights of action, such theories of secondary liability should not be regarded as "separate" causes of action, but rather as falling within the existing rights of action under which primary liability is imposed.<sup>2</sup>

In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 394 (1982), for example, this Court held that where an implied private right of action existed for violations of the Commodity Exchange Act, it

<sup>2</sup> A private plaintiff often sues the same defendant on both primary violation and aiding-and-abetting theories under Rule 10b-5. See, e.g., *Herman & MacLean*, 459 U.S. at 379 n.5. In addition, unlike a contribution claim—which will frequently be brought after conclusion of the lawsuit establishing overall liability, and which may name as defendants persons who were not parties to the original suit—an aiding-and-abetting claim will often be brought as part of the same lawsuit that alleges the primary violation, and name the same defendants. See 9 L. Loss & J. Seligman, *Securities Regulation* 4481 (3d ed. 1992).

"necessarily follow[ed]" that those who conspired to violate the Act were also subject to private suit. The Court did not suggest that it was implying a new or "separate" cause of action for conspiracy, 456 U.S. at 394-395, even though, of course, a conspiracy theory might reach some defendants who had not directly violated the Act. Similarly, in *American Society of Mechanical Engineers, Inc. v. Hydrolevel Corp. (ASME)*, 456 U.S. 556, 568-574 (1982), this Court held a defendant secondarily liable for antitrust violations on the theory that its agent acted with apparent authority, analyzing the case as involving the scope of the existing express right of action.<sup>3</sup> *Id.* at 569-570.

Aiding and abetting, like apparent authority and conspiracy, is a theory of secondary liability, and one properly encompassed by the existing private action under Rule 10b-5. Despite the suggestions to the contrary by petitioner and its amici (see, e.g., SIA Br. 7-10), this case thus involves no more than the rounding out of the existing implied right of action under Rule 10b-5, and there is no need to take as the central inquiry whether Congress would have intended, in the first instance, to create some wholly independent implied cause of action for aiding and abetting. The result is the same, however, under either approach, because there is substantial

<sup>3</sup> In *ASME*, 456 U.S. at 568, the Court cited with approval two federal securities fraud cases involving secondary liability. The first, *Kerbs v. Fall River Indus., Inc.*, 502 F.2d 731 (10th Cir. 1974), which the Court cited for its discussion of apparent authority, is also the leading Tenth Circuit decision allowing private actions against aiders and abettors under Rule 10b-5. In the second case, *Holloway v. Howerdd*, 536 F.2d 690 (6th Cir. 1976), the Sixth Circuit held a brokerage firm secondarily liable on a respondeat superior theory in a private action under Section 12(2) of the Securities Act of 1933, 15 U.S.C. 77l(2). Like *Curran* and *ASME*, each of the cases recognized a theory of secondary liability under an existing right of action, without purporting to imply a new or "separate" cause of action.



evidence of congressional intent to include aiders and abettors in private actions under Rule 10b-5.

**B. The Text Of Section 10(b) Supports Imposition Of Liability On Aiders And Abettors**

The broad language of Section 10(b) makes it “unlawful for any person, directly or indirectly, \* \* \* [t]o use or employ \* \* \* any manipulative or deceptive device or contrivance” “in connection with” the purchase or sale of securities. 15 U.S.C. 78j(b) (emphasis added). Congress thus intended to reach all persons who engage, even if only indirectly, in proscribed activities connected with securities transactions. Moreover, this Court has made clear that the provisions of the securities laws—and Section 10(b) in particular—are to be construed broadly to further their protective and remedial purposes. *Reves v. Ernst & Young*, 494 U.S. 56, 72-73 (1990); *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971); *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972). Although the language of Section 10(b) does not in terms mention aiding and abetting, we think that when read in context it is broad enough to encompass liability for such “indirect” violations.<sup>4</sup>

Petitioner argues, citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), that aiders and abettors violate Section 10(b) only if their own actions are manipulative or deceptive. Pet. Br. 10, 13-17, 34, 36, 41. That argument ignores Section 10(b)’s “any person” and “directly or

<sup>4</sup> See *Geo. H. McFadden & Bro. v. Home-Stake Prod. Co.*, 295 F. Supp. 587, 589 (N.D. Okla. 1968) (“directly or indirectly” language in Section 10(b) includes aiders and abettors). See also *SEC v. Universal Major Indus. Corp.*, 546 F.2d 1044, 1046 (2d Cir. 1976), cert. denied, 434 U.S. 834 (1977) (“directly or indirectly” language in Section 5 of the Securities Act of 1933, 15 U.S.C. 77e, includes aiders and abettors); *In re Atlantic Financial Management, Inc.*, 784 F.2d 29, 31 (1st Cir. 1986) (noting that majority of courts of appeals have concluded that “any person” and “directly or indirectly” language of Section 10(b) accommodates some forms of secondary liability), cert. denied, 481 U.S. 1072 (1987); p. 11 & note 9, *infra*.

indirectly” language, and the fact that in *Ernst & Ernst*, 425 U.S. at 192 n.7, this Court expressly reserved the question whether aiding-and-abetting liability exists under that section. Petitioner also argues (Br. 19 & n.14) that Section 10(b) imposes no aiding-and-abetting liability because the private rights of action expressly provided by Sections 9 and 18 of the Exchange Act, 15 U.S.C. 78i, 78r, impose none. Those sections are textually similar to Section 10(b): Section 9 uses both the “any person” and “directly or indirectly” language, and Section 18 uses “any person.” Moreover, Section 9(e) expressly bases liability on “participat[ion]” in prohibited acts, which plainly encompasses aiding and abetting. Contrary to the SIA’s assertion (SIA Br. 12 n.9), courts have indicated that aiding-and-abetting liability is available under both sections,<sup>5</sup> and we are aware of no case in which a court has held that such liability is unavailable under either.

Amicus AICPA’s similar reliance (Br. 15) on the lack of aiding-and-abetting liability under Sections 11 and 12 of the Securities Act of 1993, 15 U.S.C. 77k, 77l, is misplaced for different reasons. Each of those sections sets forth precise categories of permissible defendants; neither contains the “directly or indirectly” language of Section 10(b); and each imposes a culpability requirement (strict liability or negligence) significantly different from that applicable under Section 10(b). They are thus simply inapposite here. Likewise, petitioner and its amici assert that the “controlling person” provisions of Section 20(a) of the Exchange Act, 15 U.S.C. 78t(a) were intended to supplant all other theories of secondary liability, including aiding and abetting. But the text of the section does not support

<sup>5</sup> See *Walck v. American Stock Exchange, Inc.*, 565 F. Supp. 1051, 1064 (E.D. Pa. 1981) (Section 9), aff’d, 687 F.2d 778 (3d Cir. 1982), cert. denied, 461 U.S. 942 (1983); *In re Caesars Palace Securities Litigation*, 360 F. Supp. 366, 386 (S.D.N.Y. 1973) (Section 18); *Bloor v. Dansker*, 523 F. Supp. 533, 542 (S.D.N.Y. 1980), aff’d, 754 F.2d 57 (2d Cir. 1985) (same). See also Pet. Br. 19 n.14.



—that view, and the legislative history indicates that, to the contrary, Section 20(a) was “aimed at expanding liability, rather than contracting it.” *In re Atlantic Financial Management, Inc.*, 784 F.2d at 32-34. It is therefore not surprising that every court of appeals that has considered whether Section 20(a) constitutes the sole basis for secondary liability has determined that it does not.<sup>6</sup>

Section 10(b), and particularly the term “indirectly,” must also be interpreted in light of the legal environment concerning secondary liability at the time of Section 10(b)’s enactment. Aiding-and-abetting liability is deeply rooted in the law, and it was well established in both civil and criminal actions by 1934.<sup>7</sup> Significantly, aiding-and-

<sup>6</sup> See, e.g., *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1576-1577 (9th Cir. 1990) (en banc) (“§ 20(a) was intended to supplement, and not to supplant, the common law theory of respondeat superior as a basis for vicarious liability in securities cases”), cert. denied, 499 U.S. 976 (1991). Accord *In re Atlantic Financial Management*, 784 F.2d at 32-34; *Marbury Management, Inc. v. Kohn*, 629 F.2d 705, 712-716 (2d Cir.), cert. denied, 449 U.S. 1011 (1980); *Johns Hopkins University v. Hutton*, 422 F.2d 1124, 1130 (4th Cir. 1970); *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118-1119 (5th Cir. 1980); *Holloway*, 536 F.2d at 694-695; *Fey v. Walston & Co.*, 493 F.2d 1036, 1051-1052 (7th Cir. 1974); *Commerford v. Olson*, 794 F.2d 1319, 1322-1323 (8th Cir. 1986); *Kerbs*, 502 F.2d at 740-741. See also *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 182-183 (3d Cir. 1981) (respondeat superior available against broker-dealers and accounting firms in view of “public trust of the firms involved, and the duty to supervise arising therefrom”), cert. denied, 455 U.S. 938 (1982). If Section 20(a) does not supplant respondeat superior, under which an employer may be held strictly liable for the actions of an employee, it certainly should not affect liability for aiding and abetting, which applies only when the defendant’s own conduct is culpable.

<sup>7</sup> See, e.g., Restatement of Torts § 876(b) (1939); *Prosser and Keeton on the Law Of Torts* § 46 & nn.8-9 (W. Keeton 5th ed. 1984) (citing pre-1934 civil cases); *Lincoln v. Claflin*, 74 U.S. (7 Wall.) 132, 138 (1869) (civil fraud); Act of Mar. 4, 1909, ch. 321, § 332, 35 Stat. 1152 (now codified at 18 U.S.C. 2) (criminal liability); *United States v. Peoni*, 100 F.2d 401, 402 (2d Cir. 1938) (Learned Hand, J.) (criminal case discussing English sources of aiding-and-abetting doctrine dating back to fourteenth century).

abetting liability had been applied by that time in securities fraud and related cases both under state “blue sky” statutes and under the common law.<sup>8</sup> In enacting the Exchange Act, Congress intended to expand, not restrict, investor protections under existing law. *Herman & MacLean*, 459 U.S. at 389. It is thus reasonable to conclude that, by selecting the expansive language of Section 10(b), Congress intended to include within its scope the well-established theory of aiding-and-abetting liability. Excluding aiders and abettors from liability would frustrate that intent.

**C. Congress Has Declined To Disturb The Courts’ Long-standing Interpretation That Aiders And Abettors May Be Included As Defendants In Private Actions Under Rule 10b-5**

The right of private plaintiffs to proceed against aiders and abettors under Rule 10b-5 has been widely established in the lower courts for more than 25 years. All 11 of the federal courts of appeals to address this issue have permitted such claims.<sup>9</sup> Congress may fairly be presumed

<sup>8</sup> E.g., *Randall v. California Land Buyers’ Syndicate*, 20 P.2d 331, 333 (Cal. 1933) (directors who aid and assist issuance of stock in violation of blue sky statute civilly liable to purchaser of stock); *Noll v. Woods*, 203 N.W. 848, 849-850 (Mich. 1925) (investment company president involved in sale of stock liable to purchaser under blue sky statute that referred only to “investment companies” and “dealers”); *Board of Trade v. Price*, 213 F. 336, 337 (8th Cir. 1914) (one who “aids” and “assists” purloining of market quotations may be enjoined in civil action). By early 1933, the blue sky laws of 11 states and the Territory of Hawaii had created private rights of action that expressly imposed liability on aiders and abettors. See Abrams, *The Scope Of Liability Under Section 12 of the Securities Act of 1933: “Participation” and the Pertinent Legislative Materials*, 15 Fordham Urb. L. J. 877, 945 (1987) (citing authorities).

<sup>9</sup> See the cases cited in notes 10-11 of the government’s brief at the petition stage (U.S. Amicus Br. 9-10). The only court of appeals not to address the issue has permitted Rule 10b-5 claims against aiders and abettors in Commission actions. *Dirks v. SEC*, 681 F.2d 824, 844 (D.C. Cir. 1982), rev’d on other grounds, 463 U.S. 646 (1983). See also *Zoelsch*

to be aware of such an important and widespread judicial interpretation of a statute, and to adopt that interpretation when it comprehensively reenacts or amends the statute without relevant change. *Lorillard v. Pons*, 434 U.S. 575, 580-581 (1978); *Cannon v. University of Chicago*, 441 U.S. 677, 698-699 (1979).

In *Herman & MacLean*, the Court unanimously confirmed the cumulative nature of the Rule 10b-5 implied private right of action, rejecting the argument that the plaintiff was limited to express rights. The Court noted that, in 1975, Congress comprehensively amended the Securities Exchange Act, undertaking the "most substantial and significant revision of this country's Federal securities laws since the passage of the Securities Exchange Act in 1934." 459 U.S. at 384-85 (citations omitted). Congress did so without overturning the prevalent judicial interpretation treating the Section 10(b) private right of action as cumulative. "In light of this well-established judicial interpretation, Congress' decision to leave Section 10(b) intact suggests that Congress ratified the cumulative nature of the § 10(b) action."<sup>10</sup> 459 U.S. at 385-386.

*v. Arthur Andersen & Co.*, 824 F.2d 27, 35-36 (D.C. Cir. 1987) (dismissing claim on facts but acknowledging elements of aider-and-abettor liability recognized by other courts of appeals). Commentators have likewise recognized aiding-and-abetting liability under the Rule 10b-5 private action. See Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification and Contribution*, 120 U. Pa. L. Rev. 597, 632-633, 638, 645-646 (1972); 5B A. Jacobs, *Litigation and Practice Under Rule 10b-5* § 40.02 (2d ed. 1993).

<sup>10</sup> Similarly, in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. at 376, the Court found that by the time Congress "comprehensively reexamined and strengthened" the Commodity Exchange Act in 1974, federal courts had consistently recognized an implied private right of action under that statute. Accordingly, the implied right was part of the "contemporary legal context," and the fact that the 1974 amendments "left intact the statutory provisions under which the federal courts had implied a cause of action \* \* \* evidence[d]

That principle applies with even greater force to private aiding and abetting liability under Section 10(b). When Congress comprehensively amended the Exchange Act in 1975, it specifically focused on the private action, overturning court decisions involving Section 10(b) private rights of action with which it disagreed.<sup>11</sup> It did not, however, disturb the by then widespread recognition by the federal courts that aiders and abettors could be sued in such actions,<sup>12</sup> although it plainly knew how to do so had it desired such a result.

Later Exchange Act amendments also reflect congressional approval both of implied private actions and of aiding and abetting liability. In 1977, Congress enacted the Foreign Corrupt Practices Act, Pub. L. No. 95-213, 91 Stat. 1494, which among other things, amended the Exchange Act. The House Committee explicitly approved existing Exchange Act implied private rights of action,

that Congress affirmatively intended to preserve that remedy." *Id.* at 381-382.

<sup>11</sup> See Section 21(g) of the Exchange Act, 15 U.S.C. 78u(g) (prohibiting consolidation of Commission injunctive actions with private actions in the absence of Commission consent); S. Rep. No. 75, 94th Cong., 1st Sess. 75-77 (1975) (citing decisions disapproved by Congress).

<sup>12</sup> For some ten years prior to 1975 a large and growing body of courts, including five federal courts of appeals, had embraced aiding and abetting liability in Rule 10b-5 private actions. See, e.g., *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673, 680-681 (N.D. Ind. 1966); *Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135, 144 (7th Cir.), cert. denied, 396 U.S. 838 (1969); *Landy v. FDIC*, 486 F.2d 139, 162-163 (3d Cir. 1973), cert. denied, 416 U.S. 960 (1974); *Kerbs*, 502 F.2d at 740; *Zabriskie v. Lewis*, 507 F.2d 546, 554 (10th Cir. 1974); *Strong v. France*, 474 F.2d 747, 752 (9th Cir. 1973); *Lanza v. Drexel & Co.*, 479 F.2d 1277, 1278 (2d Cir. 1973) (en banc) (dictum); *Green v. Jonhop, Inc.*, 358 F. Supp. 413, 419 (D. Or. 1973); *Anderson v. Francis I. DuPont & Co.*, 291 F. Supp. 705, 709 (D. Minn. 1968); *Fischer v. Kletz*, 266 F. Supp. 180, 190 (S.D.N.Y. 1967); *Pettit v. American Stock Exchange*, 217 F. Supp. 21, 28 (S.D.N.Y. 1963). See also Ruder, *supra*, 120 U. Pa. L. Rev. at 599. As petitioner concedes (Br. 29), no court has held to the contrary.



expressing its intent that "the courts shall recognize a private cause of action based on this legislation, as they have in cases involving other provisions of the Securities Exchange Act, on behalf of persons who suffer injury as a result of prohibited [practices]." H.R. Rep. No. 640, 95th Cong., 1st Sess. 10 (1977). Likewise, in 1984 Congress passed the Insider Trading Sanctions Act, Pub. L. No. 98-376, § 2, 98 Stat. 1264, which added a treble civil penalty provision applicable in Commission enforcement actions to tippers who aid or abet insider trading violations. 15 U.S.C. 78u(d)(2)(A) (Supp. V 1987). The House Report particularly "endorse[d] the judicial application of the concept of aiding and abetting liability to achieve the remedial purposes of the securities laws." H.R. Rep. No. 355, 98th Cong., 2d Sess. 10 (1983). In addition to a Commission case, the report cited *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38 (2d Cir.), cert. denied, 439 U.S. 1039 (1978), a leading Second-Circuit decision that held an aider and abettor liable in a private action under Rule 10b-5.

Even more recently, Congress amended the Exchange Act in the Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, § 5, 102 Stat. 4680. That Act added Exchange Act Section 20A, which provides an express action to contemporaneous traders for insider trading violations, and states that "[n]othing in this section shall be construed to limit or condition \* \* \* the availability of any cause of action implied from a provision of this title." 15 U.S.C. 78t-1(d); see also H.R. Rep. No. 910, 100th Cong., 2d Sess. 27 n.23 (1988) (1988 Act would not "affect the availability of any other theories of liability, such as aiding and abetting[,] \* \* \* in appropriate circumstances"). Last term this Court construed the enactment of Section 20A as a congressional "acknowledgement" of the existence of the private action under Rule 10b-5, and of judicial authority "to shape, within

limits, the 10b-5 cause of action." *Musick, Peeler*, 113 S. Ct. at 2089.<sup>13</sup>

In the face of this recent evidence of congressional approval, petitioner (Br. 20-22 & n.15) and its amici (AICPA Br. 12 n.7; SIA Br. 15-16) assert to the contrary that Congress's "rejection" of amendments proposed in 1957, 1959 and 1960 demonstrates an intent to exclude aiders and abettors from liability. That argument mischaracterizes the legislative history. The proposal in question, originally part of a proposed comprehensive revision of the federal securities laws, would have amended Exchange Act Section 20(b), and was intended to confirm the Commission's right (then established in the courts) to proceed against aiders and abettors. It was not intended to address private rights of action. See *Hearings on Senate Bills 1178-1182 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 86th Cong., 1st Sess. 335 (1959) (Commission statement). Moreover, the proposal was not "rejected." In 1960, the responsible House committee reported favorably on the original legislation, and the Senate passed a modified version, which would have amended the Commission's express right to seek injunctive relief under Exchange Act Section 21 (referred to incorrectly in the Senate report as Section 20(b)). See H.R. Rep. No. 2177, 86th Cong., 2d Sess. (1960); S. Rep. No. 1757, 86th Cong., 2d Sess. (1960); 106 Cong. Rec. 15,613, 16,457-16,458 (1960). Further consideration of the proposal was postponed, however, "due to the lack of time remaining in the term," L. Loss & J. Seligman, *Securities Regulation* 205-206 & n.80 (2d ed. 1961) (quoting 106 Cong. Rec. 15,611-15,612 (1960)); see also *Brennan*, 259 F. Supp. at 677-680, and it was not revived in subsequent Congresses. In any event, the more recent legislative record, developed at a time when the courts had uniformly

<sup>13</sup> The history of the 1988 legislation likewise acknowledges the existence of the implied private right under Rule 10b-5. See, e.g., 134 Cong. Rec. 17,218, 17,220 (1988) (remarks of Senator Garn).



approved aiding and abetting liability under 10(b), provides far more compelling evidence of congressional intent.

**D. Policy Considerations Support The Inclusion Of Aiders And Abettors As Defendants**

As this Court has noted, the Commission has only limited resources to detect or investigate federal securities law violations, and private actions accordingly serve as "a necessary supplement to Commission action." *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964); *Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988). In the Commission's own actions under Rule 10b-5, the established right to proceed against aiders and abettors is critical to effective enforcement. See note 15, *infra*. The private right of action's effectiveness as a supplement to Commission enforcement would be severely undercut if it did not also reach aiders and abettors.

Private actions also serve the compensatory purposes of the securities laws. Although the Commission may seek certain monetary relief, its remedies are designed primarily to deter violations by making them unprofitable, rather than to make investors whole. See *SEC v. Coven*, 581 F.2d 1020, 1027-1028 (2d Cir. 1978), cert. denied, 440 U.S. 950 (1979). Accordingly, the primary means of compensating injured investors remains the private action, and all participants in a fraud should be liable in order to ensure full recovery.

Amicus AICPA asserts (Br. 17-20) that aiding and abetting liability sweeps too broadly and that it is too easy for a plaintiff to allege that routine business functions aid and abet violations of the securities laws. It is possible, of course, for any private right of action under the securities laws to give rise to some unfounded or vexatious claims. The proper response to such problems, however, is not to jettison a whole class of defendants or substantive theory of liability (such as aiding and abetting), but rather to

fashion safeguards to reduce frivolous claims against both primary violators and aiders and abettors.<sup>14</sup>

Finally, as noted above, it has long been settled in the lower courts that private plaintiffs may sue aiders and abettors under Rule 10b-5. Many hundreds of reported cases reflect this uniformity. A decision by this Court dispensing with aiding and abetting liability in private actions would unquestionably have a major impact on the well-established law governing such actions. The Court should thus give considerable weight to the lower courts' longstanding acceptance of the aiding and abetting principle of liability. See *Musick, Peeler*, 113 S. Ct. 2091; *Blue Chip Stamps*, 421 U.S. at 733; see also *Curran*, 456 U.S. at 376. Indeed, in discussing the implied private right of action under Rule 10b-5, this Court has acknowledged that a rule of law consistently applied for several decades may become established "beyond peradventure." *Herman & MacLean*, 459 U.S. at 380. Particularly in light of the evidence of congressional approval discussed above, any decision to reverse direction and reject aider and abettor liability under Rule 10b-5 would, at this late date, be better left to Congress.<sup>15</sup>

<sup>14</sup> The AICPA also asserts (Br. 17-19), as a policy reason for eliminating aiding and abetting liability, that an "explosion" of litigation against accountants has led to their "virtually limitless liability." If so, however, then the "explosion" is taking place within the overall bounds of existing litigation: the number of district court securities laws cases appears not to have increased during the last two decades. See *Concerning Private Litigation Under the Federal Securities Laws: Hearing Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 103d Cong., 1st Sess. 8-11 (1993) (testimony of William R. McLucas, Director of the Commission's Division of Enforcement). In addition, much of the asserted increase in liability may be based on state law negligence claims, and hence would not be affected by changes in the federal securities laws or private rights of action under them. *Ibid*.

<sup>15</sup> Commission actions under Exchange Act Section 21(d), while not involved here, also routinely seek relief against aiders and abettors. For decades, the courts have uniformly permitted the Commission to

## II. RECKLESSNESS SATISFIES THE SCIENTER REQUIREMENT FOR AIDING-AND-ABETTING LIABILITY UNDER SECTION 10(B) AND RULE 10B-5

### A. A Recklessness Standard For Aiding-And-Abetting Liability Comports With The Language And Purposes Of Section 10(b) And Rule 10b-5, While A Conscious Intent Standard Would Frustrate The Purposes Of The Statute And The Rule

The precise formulation for establishing aiding and abetting liability varies among the circuits, but in general a plaintiff must prove: (1) a Rule 10b-5 violation by another; (2) substantial assistance by the defendant in achieving the violation; and (3) scienter on the part of the defendant.<sup>16</sup> This case concerns only the last element of the test. In our view, the court of appeals correctly adopted a recklessness standard for aiding-and-abetting liability under Rule 10b-5 where the defendant's affirmative acts

include such defendants in Rule 10b-5 cases. *E.g.*, *SEC v. Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975); *SEC v. Timetrust, Inc.*, 28 F. Supp. 34, 43 (N.D. Cal. 1939) (action under Securities Act Section 17(a)). In fiscal 1992, more than 15% of the Rule 10b-5 cases brought by the Commission included an assertion of liability for aiding and abetting. Elimination of such liability would sharply diminish the effectiveness of Commission actions. Moreover, because Commission cases are brought by a government agency, are prophylactic in nature, and seek equitable relief, the rationale for permitting aiding and abetting liability in those actions is somewhat different from (and even stronger than) the rationale in private damages actions. Accordingly, whatever the result for private actions, the Court's decision should preserve the availability of aiding and abetting liability in Commission actions.

<sup>16</sup> See U.S. Cert. Br. 10 n.11 (collecting cases). The Seventh Circuit's test is more restrictive, requiring that the aider and abettor "(1) commit one of the 'manipulative or deceptive' acts prohibited under section 10(b) and rule 10b-5 (2) with the same degree of scienter that primary liability requires." *Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1123 (7th Cir. 1990), cert. denied, 111 S. Ct. 1317 (1991).

assisted another's violation of the Rule.<sup>17</sup> Recklessness satisfies the scienter requirement for primary violations of Rule 10b-5, and the rationale used in that setting applies equally to aiding and abetting.<sup>18</sup>

1. *The recklessness standard applies to primary liability.* In *Ernst & Ernst v. Hochfelder*, this Court examined the language of Section 10(b) and evidence of congressional intent, and concluded that the statute requires "some element of scienter and cannot be read to impose liability for negligent conduct alone," 425 U.S. at 201, for "wholly faultless conduct," *id.* at 198, or for acts performed "in good faith," *id.* at 206. A recklessness standard does not, of course, impose liability for negligent,

<sup>17</sup> The Tenth Circuit, like most courts of appeals (see U.S. Cert. Br. 11 n.13), follows the Seventh Circuit's definition of recklessness, under which a reckless action would be "a highly unreasonable [action], involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir.) (citation omitted), cert. denied, 434 U.S. 875 (1977).

<sup>18</sup> One possible exception involves an alleged aider and abettor who has no independent duty to disclose or act, and whose only substantial assistance consists of silence and inaction. Under those circumstances, courts of appeals have indicated that conscious intent to aid the fraudulent scheme is or may be required. See, *e.g.*, Pet. App. A17-A18 (citing cases). This case, however, raises no such question, and we take no position on that issue. (We also take no position on the question, not raised here, whether petitioner in fact owed respondents any independent duty of disclosure.) We agree with the court of appeals, *id.* at A6-A8, A23, that petitioner's conduct constituted affirmative action. Petitioner's retraction of its demand for an independent appraisal is unlike conduct that the courts have held to consist of mere silence and inaction. See, *e.g.*, *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 776-779 (1st Cir. 1983) (persons named as directors in offering memorandum without their knowledge or consent, and who had taken no actions and made no representations); see also Pet. App. A16-A19 (finding genuine factual dispute over whether another defendant in this case substantially assisted the alleged fraud through silence and inaction).



faultless or good faith conduct. In analyzing the culpability standard under Section 10(b), the Court in *Ernst & Ernst* considered the express civil remedies in favor of purchasers or sellers of securities under the Securities Act and the Exchange Act. *Id.* at 206-208. For purposes of this case, it is significant that recklessness is sufficient to satisfy the culpability requirements under those sections.<sup>19</sup>

Moreover, the Court recognized in *Ernst & Ernst* that “[i]n certain areas of the law recklessness is considered to be a form of intentional conduct,” and indicated, without deciding, that recklessness could satisfy the scienter requirement.<sup>20</sup> 404 U.S. at 194 n.12. The *Ernst & Ernst* Court likely had common law fraud in mind as one area of law where recklessness is considered to be a form of intentional conduct. See *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d at 45 (common law as source of securities law concepts); *Straub v. Vaisman & Co.*, 540 F.2d 591, 597 (3d Cir. 1976) (common law deceit and misrepresentation relevant in interpreting Rule 10b-5); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1024 (6th Cir. 1979) (useful, after *Ernst & Ernst*, to analogize between common law

<sup>19</sup> See Securities Act §§ 11 (strict liability and negligence), 12(2) (negligence) and 15 (negligence), 15 U.S.C. 77k, 77l(2) and 77o; Exchange Act §§ 9(e) (“willfully,” a term this Court has interpreted in other contexts to include reckless disregard, see *Hazen Paper Co. v. Biggins*, 113 S. Ct. 1701, 1708-1709 (1993)), 18 (“good faith” defense), and 20 (“good faith” defense), 15 U.S.C. 78i, 78r and 78t.

<sup>20</sup> Petitioner erroneously suggests that the Court viewed Section 10(b) as requiring “conscious intent.” Pet. Br. 36; see also AICPA Br. 23; SIA Br. 18-21. The Court, however, stated only that scienter “refers to a mental state embracing intent to \* \* \* defraud,” and that the statute proscribes “knowing or intentional misconduct,” *Ernst & Ernst*, 425 U.S. at 194 n.12, 197, and it explicitly noted that recklessness might be considered “a form of intentional conduct” for these purposes. *Id.* at 194 n.12. Moreover, “[k]nowing” is a word laden with common law connotations: at common law, reckless conduct is viewed as a form of knowing conduct.” *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d at 45.

fraud and Rule 10b-5).<sup>21</sup> For purposes of common law fraud, recklessness is considered to be a form of intentional conduct, and satisfies the scienter requirement for primary liability.<sup>22</sup> One who acts with reckless disregard of potentially harmful consequences is just as culpable as one who acts with actual knowledge of such consequences.<sup>23</sup>

<sup>21</sup> Petitioner (Br. 36) and amicus SIA (Br. 21) incorrectly suggest that criminal law is the proper source to determine the scienter required for aiding and abetting liability. In fact, the courts have properly looked to common law fraud for guidance with respect to scienter under Rule 10b-5. See, e.g., *Rolf*, 570 F.2d at 46; AICPA Br. 22; Johnson, *Liability for Reckless Misrepresentations and Omissions under Section 10(b) of the Securities Exchange Act of 1934*, 59 U. Cin. L. Rev. 667, 696 (1991) (cited by both SIA and AICPA). The decisions of this Court cited by the SIA (Br. 21 n.21) stand only for the proposition that courts should evaluate whether relevant market conditions or other circumstances are so different from those under which the common law developed that a particular common law rule may not furnish complete or appropriate guidance for modern securities law. See *Basic Inc. v. Levinson*, 485 U.S. at 243-244; *Herman & MacLean*, 459 U.S. at 388-389; *Blue Chip Stamps*, 421 U.S. at 744-745. Such an evaluation in this case reveals no difference in circumstances pertinent to the degree of culpability that should be required to impose liability for aiding and abetting a fraud. Moreover, both *Basic Inc.* and *Herman & MacLean* rejected common law analogies that would have tended to thwart the Exchange Act’s protective purposes; here, in contrast, reliance on the common law would avoid a restrictive scienter requirement that would conflict with those purposes. See Johnson, *supra*, 50 U. Cin. L. Rev. at 710.

<sup>22</sup> See Restatement (Second) of Torts § 526(b), comment e (1977); *Prosser & Keeton, supra*, § 107, at 741-742.

<sup>23</sup> *Derry v. Peek*, 14 App. Cas. 337 (H.L. 1889) (“a person making a false statement [who] had shut his eyes to the facts, or purposely abstained from inquiring into them, \* \* \* [is] just as fraudulent as if he had knowingly stated that which was false”); *State Street Trust Co. v. Ernst*, 15 N.E.2d 416, 418-419 (N.Y. 1938) (accountant’s “refusal to see the obvious, a failure to investigate the doubtful, if sufficiently gross, may furnish evidence leading to an inference of fraud”; “heedlessness and reckless disregard of consequence may take the place of deliberate intention”). See also *Lehigh Zinc & Iron Co. v. Bamford*, 150 U.S. 665, 673 (1893) (one who makes representations of material facts, when he is



One underlying rationale for this rule is, of course, to discourage deliberate ignorance of facts indicating fraud. See, e.g., *State Street Co. v. Ernst*, 15 N.E.2d 416, 418-419 (N.Y. 1938). The rule also prevents a defendant from escaping liability simply by denying, falsely, any conscious intent to defraud. Proving such intent can be a daunting task, particularly when (as is frequently the case) the evidence is entirely circumstantial. In the face of these difficulties, the Commission and private parties routinely rely on proof of recklessness in complex Rule 10b-5 fraud cases. Insistence on a conscious intent standard would permit much deliberately wrongful conduct to escape liability, and "would for all intents and purposes disembowel the private cause of action under [Section] 10(b)." *Rolf*, 570 F.2d at 47.<sup>24</sup>

A recklessness standard is therefore a practical necessity for the effectiveness of aiding and abetting liability—both in private actions such as this one and, importantly, in the Commission's own enforcement program. Scienter is required under Rule 10b-5 in both types of action (see *Aaron v. SEC*, 446 U.S. 680 (1980)), and the same standard will presumably be applied in both. Since *Ernst & Ernst*, every court of appeals that has considered whether recklessness suffices for primary

conscious that he has no knowledge of the existence of such facts, is as much responsible for the injurious consequences as if he actually knew them to be false).

<sup>24</sup> See also *Mansbach*, 598 F.2d at 1025; *Hackbart v. Holmes*, 675 F.2d 1114, 1118 (10th Cir. 1982); *G. A. Thompson & Co. v. Partridge*, 636 F.2d 945, 961 n.32 (5th Cir. 1981); cf. *Herman & MacLean*, 459 U.S. at 390-391 n.30 ("If anything, the difficulty of proving the defendant's state of mind supports a lower standard of proof."). Petitioner and its amici offer no response to this weighty consideration, even though the authorities they cite view it as a reason why the recklessness standard is appropriate. See *Ruder*, *supra*, 120 U. Pa. L. Rev. at 634-636; *Johnson*, *supra*, 59 U. Cin. L. Rev. at 679.

liability under Rule 10b-5 has held that it does,<sup>25</sup> and this Court should now confirm that conclusion.

2. *The rationale for the recklessness standard applies to aiding and abetting liability.* The reasons for adopting the recklessness standard for primary liability under Rule 10b-5 apply equally to aiding and abetting. The language of Section 10(b) considered by the Court in *Ernst & Ernst* is, of course, the same in both cases. Moreover, courts in fraud cases have recognized that recklessness satisfies the scienter requirement for common law aiding and abetting. See generally Restatement (Second) of Torts, *supra*, § 876(b); see, e.g., *FDIC v. First Interstate Bank, N.A.*, 885 F.2d 423, 431 (8th Cir. 1989) (actual knowledge not required for aiding and abetting common law fraud). Requiring conscious intent would encourage aiders and abettors, as it would primary violators, to deliberately ignore facts indicating fraud. And proving conscious intent to defraud is equally difficult whether the case involves primary liability or aiding and abetting. See *Kuehnle*, *Secondary Liability Under the Federal Securities Laws*, 14 J. Corp. L. 313, 324, 327 (1988). Since *Ernst & Ernst*, every court of appeals that has considered whether recklessness satisfies the scienter requirement for aiding and abetting under Rule 10b-5 has held that it does in at least some circumstances.<sup>26</sup>

<sup>25</sup> See U.S. Cert. Br. 11 n.13. Several courts of appeals have expressly relied on the common law. See *id.* at 13 n.16. The courts have also generally relied both on the difficulties of proving conscious intent and on the broad remedial purposes of Section 10(b). See *Mansbach*, 598 F.2d at 1024-1025; *Hackbart*, 675 F.2d at 1117; *Sundstrand*, 553 F.2d at 1044. Prior to *Ernst & Ernst*, many courts that required scienter had held that recklessness sufficed. See, e.g., *Lanza v. Drexel & Co.*, 479 F.2d 1277, 1306 (2d Cir. 1973) (en banc); *Coffey*, 493 F.2d at 1314. Recklessness also satisfies scienter under the American Law Institute's proposed Federal Securities Code. ALI, *Federal Securities Code* §§ 202(147), 202(86) & comment 8 (1980).

<sup>26</sup> See U.S. Cert. Br. 12 n.14. As with primary liability, many courts requiring scienter for Rule 10b-5 aiding and abetting prior to *Ernst & Ernst* also held that recklessness sufficed. See, e.g., *Rochez*

Furthermore, a recklessness standard for aiding and abetting comports with the purposes of Section 10(b). See *Ruder, supra*, 120 U. Pa. L. Rev. at 645-646. This Court has long noted that Section 10(b) serves broad remedial purposes, and has stated that the securities laws should be liberally construed to effectuate those purposes. See, e.g., *Herman & MacLean*, 459 U.S. at 386-387. By facilitating enforcement of Rule 10b-5, the recklessness standard promotes the congressional policy embodied in the 1934 Act. See *Basic Inc.*, 485 U.S. at 245. The higher conscious intent standard, by contrast, would impede both Commission and private enforcement of the Act, thereby impairing the securities laws' function of protecting investors.<sup>27</sup>

**B. The Recklessness Standard Is Flexible, Predictable, And Preferable To Other Approaches**

In addition to the approach adopted by the court of appeals here—applying a recklessness standard where the aider and abettor's conduct consisted of affirmative

*Bros. v. Rhoades*, 527 F.2d 880, 886 (3d Cir. 1975); *SEC v. First Securities Co.*, 463 F.2d 981, 987 (7th Cir.), cert. denied, 409 U.S. 880 (1972); *SEC v. Spectrum, Ltd.*, 489 F.2d 535, 541 (2d Cir. 1973). See also *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 868 (2d Cir. 1968) (en banc) (Friendly, J., concurring) (acknowledging that recklessness may be a form of scienter), cert. denied, 394 U.S. 976 (1969).

<sup>27</sup> Petitioner's reliance (Br. 41, 48; SIA Br. 8, 27-28) on *Chiarella v. United States*, 445 U.S. 222 (1980) in determining scienter for aiding-and-abetting liability is misplaced. *Chiarella* dealt with an alleged primary violator who was silent and had no duty to speak. Petitioner does not dispute that the primary violators in this case were not silent, but made affirmative misrepresentations. The *Chiarella* duty analysis simply does not apply to such misrepresentations. Moreover, *Chiarella* did not discuss what constitutes scienter. Amicus SIA's reliance (Br. 27-28) on *Dirks v. SEC*, 463 U.S. 646 (1983), is also misplaced. The Court expressly stated in *Dirks* that the issue in the case was not scienter, but only whether the alleged primary violator had engaged in wrongful conduct. 463 U.S. at 663 n.23.

action<sup>28</sup>—the lower courts have used two other main approaches in analyzing the scienter requirement for aiding-and-abetting liability under Rule 10b-5: the "duty" approach and the "sliding scale" approach.

Applying the former approach, some courts have held that recklessness does not suffice for Rule 10b-5 aiding-and-abetting liability absent breach of a duty to disclose or act. See U.S. Cert. Br. 15-16 & nn.20-21. Absent such a breach, a plaintiff must always prove conscious intent to defraud, even if the defendant's substantial assistance consisted of affirmative action. See, e.g., *Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990); *Schatz v. Rosenberg*, 943 F.2d 485, 496 (4th Cir. 1991).

Several other courts have applied the "sliding scale" approach, under which the scienter standard depends both on the nature of the conduct and on whether the defendant had a duty to disclose.<sup>29</sup> A defendant who affirmatively acts to assist a fraudulent scheme but who has no duty to disclose is liable for aiding and abetting only if the plaintiff can prove "conscious intent[,] unless \* \* \* the assistance is unusual, \* \* \* in which case recklessness will suffice." *Akin v. Q-L Investments, Inc.*, 959 F.2d 521, 531 (5th Cir. 1992).

<sup>28</sup> The approach in this case is essentially the same as that taken by the Ninth Circuit in *Levine v. Diamanthuset, Inc.*, 950 F.2d 1478, 1484-1485 & nn.4-5 (9th Cir. 1991), and is consistent with those decisions that have suggested that recklessness would satisfy the scienter requirement in all Rule 10b-5 aiding-and-abetting cases. See *Herm v. Stafford*, 663 F.2d 669, 684 (6th Cir. 1981); *DCD Programs, Ltd. v. Leighton*, 833 F.2d 183, 188-189 (9th Cir. 1987).

<sup>29</sup> See, e.g., *Woodward v. Metro Bank*, 522 F.2d 84, 95-97 (5th Cir. 1975); *Metge v. Baehler*, 762 F.2d 621, 624-625 (8th Cir. 1985), certs. denied, 474 U.S. 1057 and 474 U.S. 1072 (1986); *Schneberger v. Wheeler*, 859 F.2d 1477, 1480-1481 (11th Cir. 1988), cert. denied, 490 U.S. 1091 (1989). Petitioner uses the term "sliding scale" differently (Br. 38-40), combining the "duty" and "sliding scale" approaches discussed here to produce a "majority rule sliding scale" approach.



In contrast to those approaches, the standard we urge focuses on recklessness—that is, an extreme departure from ordinary care (see note 17, *supra*). It requires a state of mind closer to conscious intent than to gross negligence. In our view, it combines flexibility and predictability more effectively than either the “duty” or the “sliding scale” approach. What is a “highly unreasonable” omission or an “extreme” departure from “standards of ordinary care” turns on the facts of each case. That focus accords with the judicial view that aiding-and-abetting liability should be determined flexibly, based on particular circumstances. See, e.g., *Camp v. Dema*, 948 F.2d 455, 459 (8th Cir. 1991); *Woodward*, 522 F.2d at 94; *FDIC v. First Interstate Bank, N.A.*, 885 F.2d 423, 429 (8th Cir. 1989).

The “duty” approach lacks this flexibility and places too severe a limit on Rule 10b-5 aiding and abetting liability based on a defendant’s affirmative acts. The source of the idea that scienter for aiding and abetting liability should turn on a duty to disclose or act is unclear. Where aiding and abetting consists of silence and inaction, requiring a breach of duty before imposing liability is arguably consistent with the common law precept that mere bystanders are not liable if they have no duty to speak or act.<sup>30</sup> Where the defendant takes affirmative action, however, the rationale for such protection does not exist.<sup>31</sup> To engraft a duty requirement on Rule 10b-5 aiding and

<sup>30</sup> See *Prosser & Keeton*, *supra*, § 56, at 373-377 (citing cases); *Louisville & N. R.R. v. Scruggs & Echols*, 49 So. 399, 400 (Ala. 1909) (“law imposes no duty on one man to aid another”). See also Restatement (Second) of Torts, *supra*, § 551(2)(a). Petitioner claims (Br. 47) that a rule distinguishing action from inaction is unworkable. That distinction, however, is fundamental in the law, including in traditional determinations of “bystander” liability.

<sup>31</sup> See *Prosser & Keeton*, *supra*, § 56, at 378-382 (citing cases); *Black v. New York, N.H. & H. R.R.*, 79 N.E. 797, 798 (Mass. 1907) (once aid is undertaken, actor must use ordinary care); *Zelenko v. Gimbel Bros.*, 287 N.Y.S. 134, 135 (Sup. Ct. 1935) *aff’d*, 287 N.Y.S. 136 (App. Div. 1936) (same).

abetting liability in the latter circumstances would serve no useful purpose, and would only pointlessly hinder both Commission and private enforcement of the securities laws.

While flexible, the recklessness standard sets a high level of culpability: a form of intent, and a standard clearly distinguishable from negligence.<sup>32</sup> Fears of unwarranted liability are thus exaggerated. See *Ruder*, *supra*, 120 U. Pa. L. Rev. at 632-633, 638.<sup>33</sup> Experience suggests that courts have not hesitated, in appropriate circumstances, to find defendants (either primary violators or aiders and abettors) in Rule 10b-5 actions not liable under a recklessness standard.<sup>34</sup> Indeed, if the Court upholds

<sup>32</sup> The Court recognized this distinction in *Ernst & Ernst*, 425 U.S. at 193-194 n.12, 197, 199, 201. See also *Sanders v. John Nuveen & Co.*, 554 F.2d 790, 793 (7th Cir. 1977), cert. denied, 450 U.S. 1005 (1981) (recklessness should be regarded as a “lesser form of intent” rather than “merely a greater degree of ordinary negligence”). The *Sundstrand* standard (see note 17, *supra*) is generally considered to impose a relatively high level of culpability. See, e.g., *Broad v. Rockwell Int’l Corp.*, 642 F.2d 929, 961-962 (5th Cir.), cert. denied, 454 U.S. 965 (1981); *G.A. Thompson & Co.*, 636 F.2d at 945; *White v. Sanders*, 689 F.2d 1366, 1367 n.4 (11th Cir. 1982). Historically, moreover, the recklessness standard developed in contradistinction to negligence. At common law, recklessness, like conscious intent, involves a culpable mental state, while negligence does not. See *Prosser & Keeton*, *supra* § 107; Restatement (Second) of Torts, *supra*, §§ 552 comment a, 526(b) comment e. Cf. *Hazen Paper Co. v. Biggins*, 113 S. Ct. 1701, 1708-1710 (1993) (“willfulness” equated to “knowledge or reckless disregard”).

<sup>33</sup> In relying (Pet. Br. 49) on the statement that “[k]nowledge of wrongful purpose thus becomes a crucial element in aiding and abetting” cases, 120 U. Pa. L. Rev. at 630-631, petitioner overlooks *Ruder’s* elaboration that recklessness satisfies that requirement. *Id.* at 636, 638.

<sup>34</sup> See, e.g., *Marbury Management, Inc. v. Kohn*, 470 F. Supp. 509 (S.D.N.Y. 1979) (alleged aiders and abettors); *Lingenfelter v. Title Ins. Co.*, 442 F. Supp. 981 (D. Neb. 1977) (same); *Hoffman v. Estabrook & Co.*, 587 F.2d 509 (1st Cir. 1978) (alleged primary violators); *Cook v. Avien, Inc.*, 573 F.2d 685 (1st Cir. 1978) (same); *Decker v. Massey-Ferguson, Ltd.*, 681 F.2d 111 (2d Cir. 1982) (same); *State Teacher’s Retirement Board v. Fluor Corp.*, 654 F.2d 843 (2d Cir. 1981) (same);



application of that standard in this case, petitioner will have every opportunity to demonstrate at trial that its actions were in fact routine and reasonable, or otherwise not reckless. Thus, although some courts have expressed concern that participants in routine business transactions should not be liable for aiding and abetting absent conscious intent,<sup>35</sup> such concern is not warranted. The recklessness standard accommodates distinctions among varying types of assistance, as well as differences in the level, remoteness, and routineness of the conduct.<sup>36</sup>

The recklessness standard is also predictable. A potential aider and abettor knows that his affirmative conduct will be judged under a recklessness standard according to objective standards applicable to the particular situation. The "sliding scale" approach lacks this predictability; indeed, the need to categorize varying fact patterns simply in order to determine the applicable standard of scienter complicates the analysis and increases the possibility of conflicting results. Finally, to the extent that the "sliding scale" approach ultimately imposes a conscious intent standard, it adversely affects enforcement of the securities laws.<sup>37</sup>

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*McLean v. Alexander*, 599 F.2d 1190 (3d Cir. 1979) (same); *Coleco Industries, Inc. v. Berman*, 567 F.2d 569 (3d Cir. 1977), cert. denied, 439 U.S. 830 (1978) (same); *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929 (5th Cir.), cert. denied, 454 U.S. 965 (1981) (same); *Croy v. Campbell*, 624 F.2d 709 (5th Cir. 1980) (same); *Sanders v. John Nuveen & Co.* 554 F.2d 790 (7th Cir. 1977), cert. denied, 450 U.S. 1091 (1989) (same).

<sup>35</sup> See, e.g., *Camp*, 948 F.2d at 459-464; *Woods v. Barnett Bank* 765 F.2d 1004, 1009-1010 (11th Cir. 1985); *Woodward*, 522 F.2d at 97, 100.

<sup>36</sup> The recklessness standard is nonetheless more restrained in its flexibility than is the "sliding scale" approach. Recklessness, for example, must take current standards of conduct applicable to the defendant's profession or position. The "sliding scale" approach has no similar reference to provide guidance.

<sup>37</sup> Petitioner argues (Br. 43-44) that this Court should adopt the Seventh Circuit's approach (see note 16, *supra*). Even the authority petitioner cites (Br. 38, 40) acknowledges, however, that that court has effectively abolished Rule 10b-5 aiding-and-abetting liability, in a

The AICPA and SIA argue that a recklessness standard is arbitrary and virtually indistinguishable from negligence. SIA Br. 22-26; AICPA Br. 27-28. But the primary authority cited for that proposition in fact disagrees with their view that the recklessness standard should be abandoned, concluding instead that it should satisfy Rule 10b-5's scienter requirement and that its rejection would mark a radical departure from settled common law. Johnson, *supra*, 59 U. Cin. L. Rev. at 695-696, 705-706, 710. For the most part, amici's criticism is directed not to the prevailing *Sundstrand* standard of recklessness (see note 17, *supra*), but rather to standards never used, or now abandoned, in Rule 10b-5 cases.<sup>38</sup> Nor has the Commission criticized the *Sundstrand* standard, properly construed, as being unworkable or indistinguishable from negligence.<sup>39</sup> Compare SIA Br. 23.

In sum, the scienter standard for aiding and abetting liability under Rule 10b-5 should be neither so low that liability exposure is excessive, nor so high that unlawful activity will escape deterrence and remediation. The recklessness standard avoids both liability for good faith or merely negligent conduct, and the undue weakening of

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striking departure from the consensus among the other courts of appeals. Feldman, *The Breakdown of Securities Fraud Aiding and Abetting Liability: Can A Uniform Standard Be Resurrected?*, 19 Sec. Reg. L.J. 45, 59-64, 66-67, 69, 71 (1990).

<sup>38</sup> *Smith v. Wade*, 461 U.S. 30 (1983), from which the SIA quotes only the dissent (SIA Br. 22), involved neither fraud nor securities. Moreover, the majority there was "not persuaded that a recklessness standard is too vague to be fair or useful." 461 U.S. at 49 (emphasis added).

<sup>39</sup> The Commission has taken the position that recklessness should be defined as a "conscious indifference to the truth." See *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990), cert. denied, 499 U.S. 976 (1991), SEC Br. Re Rehearing 13-14. That definition, however, is derived from common law deceit and fraudulent misrepresentation—not, as the SIA erroneously suggests (SIA Br. 24), from concepts of negligence.

the securities laws that would result from insistence on often elusive proof of conscious intent.

### CONCLUSION

The judgment of the court of appeals should be affirmed.  
Respectfully submitted.

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SEPTEMBER 1993